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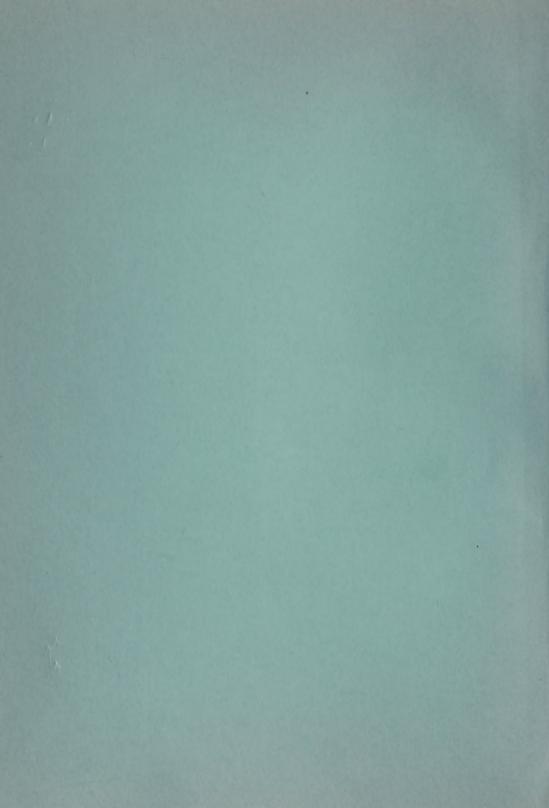
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NO. 20942

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ROBERT C. HILL,

Appellant,

VS.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED

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Attorney for Appellant



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UNITED STATES OF AMERICA,

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APPELLANT'S OPENING BRIEF

JURISDIC TION

Jurisdiction to try the case was within the Federal District Court pursuant to Title 18 U.S.C. Section 3231.

A jury trial was held in the Federal District Court, Southern District of California, Central Division, before Judge Raymond E. Plummer, on January 18, 1965, and appellant was subsequently found guilty on 26 counts of a 29 count indictment for mail fraud, Title 18 U.S.C. Section 1341.

Judge Plummer sentenced appellant to two year's imprisonment on each count, sentences to run concurrently, and to pay all costs of prosecution as provided by Title 28 U.S.C. Section 1918(b), the amount to be taxed according to Title 28 U.S.C. Section 1924,

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and inserted by the Clerk of the Court.

This is an appeal from an Order denying Appellant's Motion to Suppress Evidence, pursuant to Rule 41(e) of the Federal Rules of Criminal Procedure and Appellant's Motion For Dismissal For Lack of Due Process of Law under the United States Constitution, Amendments 4, 5 and 14.

STATEMENT OF THE CASE

Prior to the year of 1958, appellant had worked in the field of small business financing with the companies of Business Mart of America (R. T. 1691) and Lenders Service Corporation (R. T. 1694), both California corporations. In March, 1958, appellant inserted an ad in the Los Angeles Times soliciting a business associate that had experience in the field of general financing (R. T. 1697, 1698). Through this ad, appellant met Mr. Carl Kaub (R. T. 1698), who was President of National Mortgage Co., Los Angeles, California. With the help of Carl Kaub, appellant formed the corporation known as Inter-American Loan Service, hereinafter referred to as IALS, in order to solicit people to borrow money from National Mortgage Co. (R. T. 1701). Appellant was the president, owner, and operator of IALS until March 30, 1959, when he received an Order from the California Corporations Commissioner to cease and desist from continuing to transact business as IALS (R. T. 135). As a result of this Order, on April 17, 1959. appellant turned over all records of IALS along with his personal



records to the United Lender's Service for further processing and storage (R. T. 124, 125, 1785). These records were turned over to Mr. Scherief Momaud, who was the manager for United Lender's Service, a corporation. Appellant had no interest whatsoever in the business of the United Lender's Service (R. T. 124, 125). Appellant gave no authority to Mr. Scherief Momaud to disclose, exhibit, transfer or convey the records to any other party (R. T. 126).

In July, 1959, Mrs. Leland Hill, the sister-in-law of appellant, went to the offices of United Lender's Service, and removed all of the records on the premises including those of IALS and appellant's personal records. She took them to her home in West Los Angeles (R. T. 142). Mrs. Leland Hill stated that she did not have permission from appellant, Mr. Scherief Momaud, Mr. Leland Hill, or anyone else connected with United Lender's Service or IALS to remove the records (R. T. 142, 145).

During the period of April 17, 1959 to July, 1959, appellant was arrested on a criminal complaint issued out of Fresno County, California, for violation of Section 112 of the California Penal Code, Criminal Conspiracy, and was either in custody or out on bail (R. T. 153). This charge against appellant was later dismissed on motion of the District Attorney, and appellant plead guilty to violation of Section 10131 of the California Real Estate Code, a misdemeanor, acting as a broker without obtaining a license.

During the period of time that appellant was charged under Section 112 of the California Penal Code, the acting Chief of Police of



Selma, California, Mr. William Doren Davis, attempted to obtain evidence against appellant and in furtherance thereof, he obtained a Search Warrant from the Honorable Judge Kathleen Parker, Los Angeles Municipal Court, for the records of IALS and/or Mr. Robert Hill, appellant (R. T. 153, 154) (Plaintiff's Exhibit No. 36). Chief Davis proceeded to the three places specified in the Search Warrant, #496, and could find no persons or records at any of the places specified therein (R. T. 176). Chief Davis obtained no Search Warrant other than #496, referred to above (R. T. 165). Chief Davis was subsequently informed that the records of IALS and/or appellant, Robert Hill, were being stored at the home of Mrs. Leland Hill. Chief Davis along with Deputy District Attorney Michael Kershaw of Fresno County and a Los Angeles detective, proceeded to the home of Mrs. Leland Hill, wherein he identified himself and told Mrs. Hill that he had a Search Warrant for the records of IALS and Mr. Robert Hill (R. T. 155). Mrs. Leland Hill informed Chief Davis that he would not need a Search Warrant for the records and she subsequently unlocked the garage door at her home and allowed them to take all of the records that she had stored there (R. T. 155). Chief Davis subsequently returned Search Warrant #496, with a signed affidavit that it was not served on anyone, that there was no evidence obtained from the Search Warrant (R. T. 175). Mr. Michael Kershaw subsequently sent a letter to the Los Angeles Municipal Court stating that no evidence was obtained from the Search Warrant (Plaintiff's Exhibit #37).

The records were subsequently taken by car to the office



of the District Attorney in Fresno County (R. T. 1730) and the boxes were separated and stored in different offices. None of the files or records of IALS were ever used against appellant in Fresno County (R. T. 1737), nor were they ever returned to appellant. All of the files and records were subsequently turned over to the United States Postal Inspector in the year 1959 or 1960 (R. T. 510, 511, 1738). The United States Government had continuous control and custody of all of the files and records of IALS from the year 1959 or 1960 to present.

On April 10, 1964, appellant filed his Motion to Suppress Evidence (C. T. 48) and said Motion was denied. On January 18, 1965, the defendant filed a Motion to Dismiss for Lack of Due Process of Law (C. T. 75), and said Motion was denied. On January 18, 1965, defendant filed his second Motion To Suppress Evidence (C. T. 77), and said Motion was denied (R. T. 185). The records of IALS were subsequently admitted into evidence and used against appellant over the continuing objection of appellant's counsel (R. T. 293).

QUESTIONS INVOLVED

- 1. Can appellant raise the issue of unlawful search and seizure of alleged corporate records when the search is directed against him and not against the corporation and he is the president, owner and sole operator of the company?
 - 2. Was there a lawful search and seizure of IALS



records by state authorities when Chief Davis obtained these records without a valid search warrant (R. T. 176) from the home of Mrs. Leland Hill, upon his stating to her that he had a search warrant for the records of the company (R. T. 155)?

- 3. Could Mrs. Leland Hill, who had no interest in the property, consent to the search and seizure of IALS records when she obtained these records without the owner's permission and was never authorized to release them?
- 4. If the records of IALS were unlawfully obtained through illegal search and seizure by state authorities, can these records be used against appellant by federal authorities who had subsequently obtained the records from the state authorities?
- 5. Was appellant denied his constitutional right for lack of due process when all of his records were in the hands of the prosecution for over four years; when he could not recall from memory the contents of the files; when he was first shown the files a few days or weeks before the trial and large numbers of documents were missing from them which would have helped him in his defense?

SPECIFICATION OF ERRORS

The trial court erred in:

1. Denying appellant's Motion to Suppress Evidence of an unlawful search and seizure by state authorities of alleged corporate records on the grounds that the search was directed



against IALS and not against appellant. The corporation never issued any stock (R. T. 121), and the two original incorporators besides appellant were nothing but straw people because of the necessity that a corporation have three directors (R. T. 1860, 1861). Even the prosecuting attorney stated that appellant was the owner, organizer, and operator of IALS (R. T. 102, 2045).

The trial court ruled that appellant's Motion to Suppress Evidence was denied because the records that were seized by the state authorities were corporate records and not the records of appellant. The court also stated that the corporation was not protesting nor objecting nor were the records being used against the corporation (R. T. 184).

Appellant's attorney had a continuing objection to all evidence introduced by the prosecution based upon the allegation that all such evidence was obtained by illegal search and seizure and the trial court allowed the continuing objection (R. T. 293).

2. Allowing the records of IALS to be introduced into evidence by the prosecution when they were obtained under false pretenses. The trial court never ruled as to whether there was a valid search and seizure of the records by Chief Davis when he obtained them from the home of Mrs. Leland Hill.

It was admitted by Chief Davis that he only obtained one search warrant #496, and that it was signed by Municipal Court Judge Kathleen Parker (R. T. 141). He admits that he went to the three places designated in the search warrant and found no people at these places and that he subsequently went to the home of Mrs.



Leland Hill whose address was not included in the search warrant (R. T. 176). Chief Davis told Mrs. Hill that he had a search warrant for the records of the loan company and she replied that he didn't need a search warrant (R. T. 155).

3. Allowing the records of IALS to be introduced into evidence by the prosecution when they were obtained through unlawful search and seizure, by state authorities, from Mrs. Leland Hill, who had no authority to give these records to anyone, and who had no interest whatsoever in the property (R. T. 145, 146).

The trial court never ruled on whether there was a lawful search and seizure of IALS' records when they were taken from Mrs. Leland Hill by the state authorities.

4. Not excluding the records of IALS, when introduced by the prosecution, under the Silver Platter Doctrine. These records were turned over to the federal authorities by state authorities in the year 1959 or 1960 (R. T. 511). The Silver Platter Doctrine precludes evidence which is unlawfully obtained by state authorities, through illegal search and seizure, from being used by federal authorities against a defendant.

The trial court did not rule on the Silver Platter Doctrine since the Court did not determine whether the evidence was obtained through illegal search and seizure. Appellant contends that the records of IALS were obtained through illegal search and seizure and therefore could not be used by federal authorities in the present case.

5. Denying appellant's Motion to Dismiss for Lack of



Due Process of Law (R. T. 185) since appellant was denied his constitutional rights under the United States Constitution, Amendments 4, 5 and 14. The United States Government had all of appellant's files for over four years prior to the time that it filed an indictment against him. Prior to that time, the files remained in the hands of the Fresno County District Attorney's office and were scattered about in various offices. When appellant was allowed to examine these files shortly before trial, he discovered that numerous papers and documents were missing, and he was therefore unable to furnish a defense to the indictment against him.

ARGUMENT

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THE TRIAL COURT ERRED IN DENYING APPELLANT'S MOTION TO SUPPRESS EVIDENCE WHERE THIS EVIDENCE WAS OBTAINED BY STATE AUTHORITIES THROUGH ILLEGAL SEARCH AND SEIZURE AND WAS SUBSEQUENTLY HANDED OVER TO THE FEDERAL AUTHORITIES FOR FEDERAL PROSECUTION.

A. Appellant contends that the records of IALS should not have been allowed into evidence and that appellant's Motion to Suppress Evidence should have been granted. Appellant would not have been convicted if this evidence was suppressed, since every witness against appellant testified as to some document that was illegally obtained (R. T. 2033). In addition, all of the alleged victims were contacted through these documents and proof of mailing was established by the correspondence in the files of IALS.



The U. S. Attorney's Office waited over four years to bring the indictment against appellant, and during this entire time, it had all of appellant's records. Why did it wait so long? No one will ever be certain of the correct answer to this question, but one can conjecture that the documents were considered to be illegally obtained and therefore no case could be made against appellant. When the five year statute of limitations approached, the U. S. Attorney's Office probably decided to risk the chance of the documents' legality in its possession, and filed an indictment against appellant. Of course, appellant had little or no recollection of the contents of his files due to the long period of time that had passed, and therefore, he had little chance of refuting the incriminating evidence that was introduced against him during the trial.

The trial judge made a finding that the files and records of IALS belonged to a corporation and therefore appellant had no standing to object to its introduction on the ground of illegal search and seizure. The Court made no other findings on the various other questions that were raised by appellant's Motion to Suppress because these questions were considered moot after its ruling that the records belonged to a corporation.

The trial court's ruling on appellant's Motion to Suppress was clearly erroneous. Chief Davis had a criminal complaint against appellant at the time that he obtained the search warrant and he was not concerned with IALS. He testified that he was looking for evidence against appellant and no mention was made of the IALS corporation as a defendant. It should be noted that IALS was



no longer in business at the time Chief Davis obtained these records. Appellant was IALS. Uncontradicted testimony, confirmed by the prosecuting attorney, was that appellant was the president, organizer, owner, and operator of IALS. No corporation stock was ever issued. The required two other directors were merely straw people.

The law is clear:

"In order to qualify as a 'person aggrieved by an unlawful search and seizure', one must have been a victim of a search of seizure, one against whom the search was directed, as distinguished from one who claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else. . . ." Jones v. United States, 362 U.S. 257, 261 (1960).

Even appellee agrees with this law since appellee gave the above citation in its opposition to defendant's Motion to Suppress Evidence (C. T. 58). The records obtained by Chief Davis were to be used against appellant and were not "evidence gathered as a consequence of a search or seizure directed at someone else". Federal Rules of Criminal Procedure, Rule 41(e) provides:

"A person aggrieved by an unlawful search and seizure may move the District Court . . . for the return of the property and to suppress for the use as evidence anything so obtained. . . ."



Appellant contends that he qualified as a "person aggrieved" within the meaning of Rule 41(e) since his standing is based upon an interest in the property that was illegally seized.

In the <u>Jones</u> case, <u>supra</u>, the authorities discovered narcotics in the awning of defendant's friend's apartment. The U. S.

Supreme Court held that defendant had standing to bring a Motion to Suppress even though defendant never alleged ownership nor possession of the seized articles, nor an interest in the premises searched.

In the present case, there is no dispute that the State authorities were only interested in appellant and not against IALS, which was already out of business, when they obtained a search warrant. Chief Davis was seeking evidence for the District Attorney of Fresno County, who has previously filed a felony complaint against appellant. The mere fact that the documents were said to belong to IALS does not subtract the interest appellant had in those papers. IALS and appellant were interchangeable since appellant formed the corporation, was the president, organizer, operator and owner of it. No stock was ever issued. In the case of Henzel v. United States, 296 F. 2d 650 (5th Cir. 1961), the defendant was prosecuted for mail fraud. Defendant was the organizer, sole stockholder, and president of the corporation. The court held that defendant could move to suppress evidence consisting of corporate records that were obtained in an unlawful search of corporate premises. On page 652, the Court stated that the Jones case, supra, was controlling, and that defendant was clearly

. .



aggrieved because he was the one against whom the search was directed (similar to the case at bar), and that it made no difference that the property seized and the premises searched were owned by a corporation rather than by an individual. A corporation has the same rights as a natural person to be free from illegal search and seizure. Also see Villano v. United States, 310 F. 2d 680 (1962).

The policy considerations should not be overlooked in cases involving illegal search and seizure. Illegally obtained evidence is suppressed to discourage unlawful police activity, not to acquit guilty defendants. So long as unlawfully obtained evidence may be used, the police are encouraged to continue violations to secure such evidence. The "Fruit of the Poisonous Tree" Doctrine expressly recognizes this. To deny the derivative standing concept would invite law enforcement officers to select one defendant to be a victim of unlawful procedure in the hope that information would be gained from him to convict others. The one defendant-victim could be allowed to go free without indictment in order to snare his contemporaries. Such a result is inconsistent with the purpose of suppressing any unlawfully secured evidence, and one may agree with Mr. Justice Holmes that "such evidence shall not be used at all".

In the present case, the trial judge erroneously ruled that appellant had no standing to object to the introduction of the records since they were corporate records, the corporation was not protesting and they were not being used against the corporation (R. T.



out of business at the time the illegal search and seizure took place. How can a nonexisting corporation object to the introduction of evidence? Unfortunately, Judge Plummer was looking at form and not substance. He saw the words IALS and ruled that it was not appellant's records. This ruling clings to the antiquated cases where technicalities prevailed and substance was secondary to rigid rules of the game. If a defendant used the wrong form on appeal, he summarily lost his case. This is not the situation today. In the last few years, the Federal Courts have looked to substance and unshackled themselves from the forms that bound them. The U. S. Supreme Court recognized this principle when it stated in Jones v. United States, supra, on page 264:

"Under Rule 41(e), 'the court in its discretion may entertain the Motion [to Suppress] at the trial or hearing.' This qualification proves that we are dealing with carrying out an important social policy and not a narrow, finicky procedural requirement."

B. The records of IALS that were obtained by Chief
Davis were taken from Mrs. Leland Hill under color of authority
when he stated that he had a search warrant for the company
records. Since Chief Davis had no valid search warrant in his
possession, the seizure of the files and records was clearly unlawful since Mrs. Hill assumed the truthfulness of the statement and
voluntarily surrendered the records to Chief Davis. In order for



a search and seizure to be valid, the individual giving the documents must freely and intelligently give his unequivocal and specific consent to the search and it must be uncontaminated by any duress or coercion, actual or implied. The government has the burden of proving by clear and positive evidence that such consent was given. Chief Davis testified that Mrs. Leland Hill stated that he did not need a search warrant after he informed her that he had one in his possession. Mrs. Leland Hill testified that she would not have given the records to Chief Davis had she not been coerced into doing so. In either situation, it is quite obvious that Mrs. Leland Hill did not freely consent to the search and seizure without actual or implied coercion.

A search warrant does not validate a search made at a location not specified in the warrant. Federal Courts apply federal standards in determining the lawfulness of a search and seizure made by state authorities, <u>U. S. Constitution</u>, Fourth Amendment; <u>Trupiano v. United States</u>, 334 U.S. 699, 710 (1948).

A search warrant is not needed when the documents are voluntarily given to the authorities by one who has a right to release them. The important question is whether Mrs. Leland Hill had a right to release them and if so, did she voluntarily release them?

Appellant contends that Mrs. Leland Hill had no right to release the records since she had no proprietary interest in them, and was never given direct or implied permission to release the records to anyone. Mere possession does not confer authority to allow search and seizure, United States v. Blok, 188 F. 2d 1019

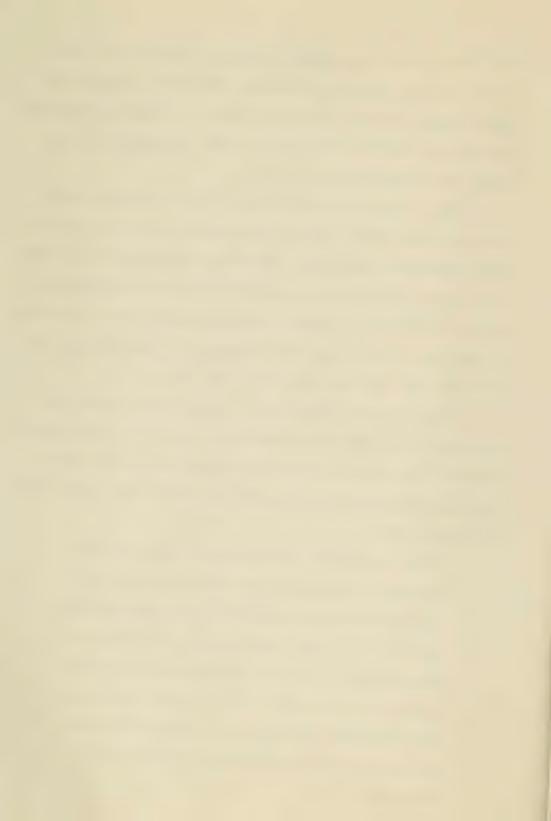


(D. C. Cir. 1951); Cunningham v. Heinze, 352 F. 2d 1 (9th Cir. 1965); Stoner v. California, 376 U.S. 483 (1964); Chapman v. United States, 365 U.S. 610 (1961); Reeves v. Warden, Maryland Penitentiary, 346 F. 2d 915 (4th Cir. 1965); Holzhey v. United States, 223 F. 2d 823 (5th Cir. 1955).

Mrs. Leland Hill never voluntarily released the records to the state authorities. She only released them through coercion of an illegal Search Warrant. Where one establishes the invalidity of the search, then "the government has the burden of convincing the Court by clear and positive testimony that there was no duress or coercion, actual or implied" by Watson v. United States, 249 F. 2d 106, 108, 101 U.S. App. D.C. 350, 352.

There appears little room for argument that Mrs. Hill submitted to authority when Chief Davis stated that he had a search warrant. This rule was forcefully brought home in the case of Judd v. United States, 190 F. 2d 649, 651 (D. C. Cir. 1951), where the Court stated:

"Thus 'invitations' to enter one's house, extended to armed officers of the law who demand entrance, are usually to be considered as invitations secured by force . . . a like view has been taken where an officer displays his badge and declares that he has come to make a search . . . even where the householder replies, 'all right' . . . Intimidation and duress are almost necessarily implicit in such situations . . . "

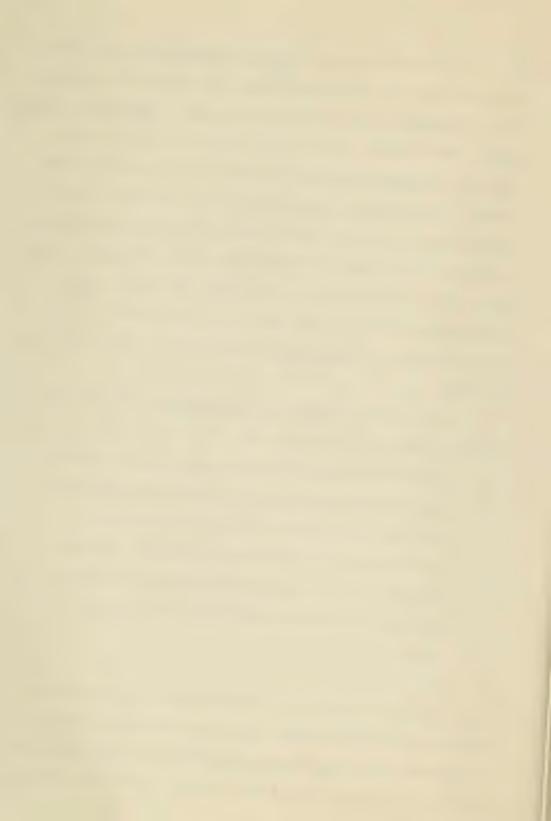


Numerous cases since Judd v. United States, supra, have squarely held that consent was vitiated even where officers do not conduct themselves in an overreaching manner. Williams v. United States, 263 F. 2d 487, 489, 105 U.S. App. D.C. 41, 43 (1959); Higgins v. United States, 209 F. 2d 819, 93 U.S. App. D.C. 340 (1954); United States v. Evans, 194 F. Supp. 90 (D.D.C. 1961); United States v. Roberts, 179 F. Supp. 478 (1959); United States v. Minor, 117 F. Supp. 697 (E.D. Okla. 1953); Whitley v. United States, 237 F. 2d 787, 99 U.S. App. D.C. 159 (1956); Lee v. United States, 232 F. 2d 354, 355, 98 U.S. App. D.C. 97, 98 (1956); Waldron v. United States, 219 F. 2d 37, 95 U.S. App. D.C. 66 (1955).

In the case of <u>Channell v. United States</u>, 285 F. 2d 217 (9th Cir. 1960), the Court held that:

"A search and seizure may be made without a search warrant if the individual freely and intelligently gives his unequivocal and specific consent to the search, uncontaminated by any duress or coercion, actual or implied. The Government has the burden of proving by clear and positive evidence that such consent was given."

The state courts have also ruled upon this question and they have held that no consent was given where authorities used implied coercion, Wilkerson v. State (1927), 37 Okla. Crim. 43, 256 Pac. 63; Rose v. State (1927), 36 Okla. Crim. 333, 254 Pac.



509; Arnold v. State (1928), 110 Tex. Crim. 529, 7 S. W. 2d 1083, 9 S. W. 2d 333.

In the case of Jordan v. State (1928), 111 Tex. Crim. 83, 11 S. W. 2d 323, the state officers were armed with a search warrant which the court found to be insufficient with respect to the premises searched. The officers told defendant's wife they had a search warrant and desired to search the house. The wife stated, "No, go ahead and search". The court held that this was not a valid search and seizure due to the officers' conduct and remarks. The Jordan case is very similar to the present case at bar.

Appellant contends that Mrs. Leland Hill was coerced into surrendering these records to the state authorities when Chief

Davis informed her that he had a search warrant for them. Appellant further contends that even if Mrs. Leland Hill was not coerced into surrendering these records, she still was not authorized to do so, and therefore, the records were illegally obtained.

could not be used against appellant in the present case. The Silver Platter Doctrine is firmly established in Federal law, as was brought out in the case of Elkins v. United States, 364 U.S. 206 (1960). The security of one's privacy against arbitrary intrusion by the police is implicit in the concept of ordered liberty and as such, enforceable against the states through the due process clause. Elkins v. United States, supra. In that case, the court stated that



the test of whether evidence has been obtained in an unreasonable search and seizure by state officers is one of federal law, neither enlarged by what one state court may have countenanced, nor diminished by what another may have colorably suppressed.

The search and seizure as conducted by Chief Davis would certainly have been unlawful if conducted by federal officers for the Fourth Amendment states that "no warrants shall issue, but upon probable cause supported by oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized". The search warrant in the hands of Chief Davis did not describe the premises of Mrs. Leland Hill.

The U. S. Supreme Court left no doubt as to the exclusion of ill gotten evidence, when it stated on page 221 of the Elkins case:

"When a Federal Court sitting in an exclusionary state admits evidence lawlessly seized by state agents, it not only frustrates state policy, but frustrates that policy in a particularly inappropriate and ironic way. For by admitting the unlawfully seized evidence, the Federal Court serves to defeat the state's effort to assure obedience to the Federal Constitution. In states which have not adopted the exclusionary rule, on the other hand, it would work no conflict with local policy for a Federal Court to decline to receive evidence unlawfully seized by state officers. The question with which we deal today affects not at all the freedom of the states to develop and apply their own sanctions in their

. .



own way. . . .

"Free and open cooperation between state and federal law enforcement officers is to be commended and encouraged. Yet that kind of cooperation is hardly promoted by a rule that implicitly invites federal officers to withdraw from such association and at least tacitly to encourage state officers in the disregard of constitutionally protected freedom. If, on the other hand, it is understood that the fruit of the unlawful search by state agents will be inadmissible in federal trial, there can be no inducement to subterfuge and evasion with respect to federal-state cooperation in criminal investigation. Instead, forthright cooperation under constitutional standards will be promoted and fostered."

The Elkins case, supra, goes on to state that the Fourth

Amendment does not forbid all search and seizures, but only

unreasonable searches and seizures.

In the present case, the records were unlawfully taken by state authorities and subsequently turned over to the federal authorities for prosecution of appellant (R. T. 510, 511, 1738). If Judge Plummer applied federal law in determining whether the records were obtained through illegal search and seizure, as stated in Elkins v. United States, supra, then appellant's Motion To Suppress should have been granted. Without these records, appellant



would never have been convicted since every Count of the Indictment was supported by some document obtained from appellant's files (R. T. 2033, also Plaintiff's Exhibits).

II

APPELLANT WAS DENIED DUE PROCESS
OF LAW UNDER AMENDMENTS FOUR, FIVE,
AND FOURTEEN, OF THE UNITED STATES
CONSTITUTION WHEN STATE AND FEDERAL
AUTHORITIES HELD HIS RECORDS FOR
OVER FOUR YEARS AND ALLOWED IMPORTANT DOCUMENTS TO BE LOST OR
TAKEN FROM THE FILES.

Approximately ten days before his trial, appellant was allowed to examine the files that were seized by the authorities over four years previous to that date. There were over two hundred files involved, and appellant was shocked to discover some folders blank and others that had documents missing that were necessary for appellant's defense (C. T. 64). No evidence was introduced as to why the documents were not returned to appellant or what happened to the missing papers. On the surface it appears that all documents that were unfavorable to appellant, or irrelevant, were retained while all documents that were favorable to appellant were discarded. Since there were numerous prosecution authorities that had possession of these documents from the time that they were taken until the time that appellant examined them on January 8, 1964, it would be impossible to point the finger of blame upon anyone. However, this should be no reason why appellant suffer the



consequences of the lost documents.

The Fourth, Fifth and Fourteenth Amendments to the United States Constitution state that the people shall be secure against unreasonable search and seizure of their property and that they shall not be deprived of liberty or property without due process of law.

Appellant was deprived of his property by unreasonable search and seizure and also without due process of law since defendant's attorney could not adequately prepare a defense to the charges against appellant without the necessary papers that were missing from the files (C. T. 75).

CONCLUSION

For the above reasons, it is respectfully submitted that the judgment on all Counts should be reversed.

Respectfully submitted,

JACK HADDAD

Attorney for Appellant.



CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Jack Haddad JACK HADDAD







APPENDIX "A"

TABLE OF EXHIBITS

Plaintiff's Exhibits	For Identification	In Evidence
36	159	172
37	172	174

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APPELLEE'S BRIEF

APPEAL FROM
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WM. B. LUCK, CLERK

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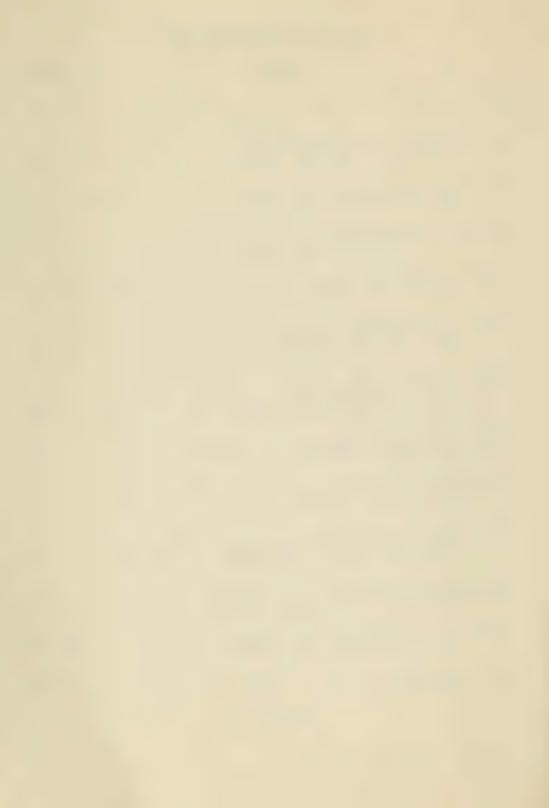
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APPELLEE'S BRIEF

Ι

JURISDICTIONAL STATEMENT

This is an appeal from a conviction on twenty-six counts of mail fraud, in violation of Section 472, Title 18, United States Code.

On February 26, 1964, an indictment returned by the February, 1964, Grand Jury was filed in the United States District Court for the Southern District of California, Central Division. It charged that appellant, Robert C. Hill, devised a scheme and artifice to defraud business owners by collecting advance fees for services in securing loans, but not making any genuine effort to perform such services. Numerous false and fraudulent



representations used to carry out the scheme were alleged. Each of the twenty-nine counts of the indictment referred to a different use of the mails for the purpose of executing this scheme.

On April 13, 1964, the appellant entered a plea of not guilty to all counts. A trial by jury commenced on January 18, 1965, before the Honorable Raymond E. Plummer, United States District Judge. On the Government's motion, Counts 9, 16 and 24 were dismissed at the close of the Government's case [R. T. 1596]. On February 8, 1965, the jury returned a verdict of guilty on all remaining counts [R. T. 2201-02]. On April 23, 1965, Judge Plummer sentenced the appellant to a term of two years on each count, to run concurrently, and further ordered appellant to pay the cost of prosecution as provided by Section 1918(b), Title 28, United States Code [R. T. 2217].

Jurisdiction of the District Court was based upon Section 3231, Title 18, United States Code. Jurisdiction of this Court to entertain the appeal is derived from Sections 1291 and 1294, Title 28, United States Code.

II

SPECIFICATION OF ERRORS

Only two issues are raised by the argument presented in Appellant's Opening Brief:



- (1) Did the trial court err in denying appellant's motion to suppress as evidence the corporate files of Inter-American Loan Service?
- (2) Was the appellant denied due process of law by the conduct of the Government in handling of the corporate files of Inter-American Loan Service?

III

STATEMENT OF FACTS

In March of 1958, the appellant, Robert C. Hill, sought employment with the National Mortgage Company, Los Angeles, California [R. T. 207]. Although being unlicensed as a broker prevented his being hired, the appellant later enlisted the personal financial backing of the President of National Mortgage, to embark on his own business [R. T. 193, 195, 198]. Appellant was given a desk at the offices of National Mortgage to operate from [R. T. 200], and on April 11, 1958, he organized and incorporated the Inter-American Loan Service, Inc. (hereinafter referred to as IALS) [R. T. 249]. There was never any association or connection between IALS and National Mortgage Company, except use of the same office, and even this arrangement was permanently terminated as of July 9, 1958 [R. T. 203]. Appellant then established an office on Wilshire Boulevard in Los Angeles [R. T. 1587]. He continued to represent, however, on his corporate letterhead, that he was "associated with National Mortgage Company for 21



years" [R. T. 1587, 1965-66].

Ostensibly the purpose of IALS was to assist clients in borrowing money from lending institutions. Clients were initially sought by means of a flyer, which was mailed to businesses listed in the directories and telephone books of various cities [R. T. 657]. This flyer advised that "Amounts from \$5,000 to \$1,000,000 are available to firms on a Business Loan basis. If your company can use long-term financing, not readily available through your local bank, we may be able to help you." [Exhibit 26-A, R. T. 657]. Across the bottom, in bold letters, appeared the names of three cities: Los Angeles, Chicago and New York [R. T. 1879]. In fact, the office of IALS on Wilshire Boulevard was the only office in existence [R. T. 1881]. The flyer included a coupon, to be detached and mailed in to IALS. From the coupons returned, leads were established for contact by salesmen [R. T. 657].

Salesmen were recruited by the appellant through want-ads placed in newspapers. There was no requirement that they have any experience as financial consultants, or any qualifications to make financial, business and property surveys or reports. Nor were salesmen given any training in these respects [R. T. 649-52]. The salesmen were instructed to use a "negative sales pitch", collect an advance fee, and immediately convert the fee to a cashier's check and forward it to the company [R. T. 654].

Each salesman was equipped with a "kit", consisting of a certificate identifying himself, a map of the United States, a list of lending institutions, a schedule of fees, as well as contracts



and "data reports" to be filled out by the salesmen [R. T. 655 ff.].

Upon contacting prospects, the salesmen would display the map, bearing numerous red dots and labeled "Central Offices of Inter-American Loan Service", to create the impression that he represented a large, well-established firm [R. T. 1015, 1381-82]. The potential client would be shown a long list of lending institutions, which were represented as "outlets where money was available through Inter-American" [R. T. 1016, 1383]. Clients were told that, upon payment of a fee which varied according to the size of the loan, IALS would arrange a loan for them [R. T. 655-56]. Many of the clients were told that IALS had achieved success in obtaining loans for others [R.T. 1355], and that, in the event IALS was unsuccessful in procuring a loan for them, the fee would be refunded [R. T. 1385-86]. The appellant was made aware that his salesmen were making such representations through numerous letters of complaint [R. T. 1889-92]. On at least one occasion, the appellant himself told a client that the fee would be returned if his efforts to secure a loan did not succeed [R. T. 572, 1398]. Once the client was "sold", a contract was signed, and a "preliminary data report" was filled out [R. T. 658, 1386-87]. These documents, and a certified check for the advance fee, were then forwarded by mail to IALS for "acceptance" [R. T. 1386-87]. No application accompanied by the requisite fee was ever rejected [R. T. 675].

Upon receipt of these papers, a letter of acceptance was sent, including forms for the customer to list credit references



and return to IALS [R. T. 659]. These references were not verified [R. T. 678]. IALS then prepared a "financial bulletin" describing the client, and mailed this bulletin to various loan agencies. A form was also sent by mail to the client, listing the loan agencies to which the "financial bulletin" had been sent [R. T. 660]. As a general rule, the lending agencies that received these bulletins ignored them. IALS had no working agreement with any of these institutions, having selected their names at random from a telephone directory [R. T. 680, 682]. No effort was made to correlate the type of loan sought with the lending institution to which the "financial bulletin" was sent [R. T. 683-84], with often ludicrous results. For example, an investment company engaged exclusively in financing three-year conditional sales contracts on pianos and organs [R. T. 1173] was sent a bulletin describing a man seeking a loan of \$40,000 for twenty years to expand his poultry supply business [R. T. 326, 1175, 1911]. A company which was engaged in purchasing conditional sales contracts from an affiliated automobile sales agency [R. T. 1307] was sent a bulletin describing a man in the wholesale pet supply business, seeking a loan of \$25,000 for ten or fifteen years to build a warehouse [R. T. 1050, 1309, 1918].

Beyond the mailing of these "bulletins", little or no effort was made by IALS to secure loans for its clients [R. T. 682].

During the entire period of existence of IALS, the applications of approximately 200 people were accepted [R. T. 1986], and fees totaling \$85,000 were collected [R. T. 1593], yet not one single



customer obtained a loan through its efforts, nor was an advance fee ever refunded or returned to any client [R. T. 693].

On March 30, 1959, the appellant was served with a "Desist and Refrain Order" by the California State Commissioner of Corporations, ordering him to refrain from further solicitation without a broker's license [R. T. 1842-43, 1975-77]. Shortly thereafter, an arrangement was made to turn over all the files concerning clients of IALS to United Lenders Service, a partnership consisting of two former employees of the appellant, the appellant's brother, and one Momaud Scherief [R. T. 662, 673, 178-85, 1983-84]. According to the appellant's own testimony, he retained no control or supervision over any of these files after they were transferred [R. T. 1982].

In the summer of 1959, an investigation commenced arising from a complaint filed against the appellant and others in Fresno County, California. Pursuant to that investigation, the Chief of Police of Selma, California, accompanied by a Deputy District Attorney for Fresno County, came to Los Angeles to obtain the corporate records of IALS [R. T. 153-54, 1725]. They secured a search warrant in Los Angeles County, but were unable to locate the records at the addresses designated in the warrant [R. T. 1726-27]. They then proceeded to the home of the appellant's brother, where they informed Phyllis Hill, the appellant's sisterin-law, that they were looking "for the records of the loan company". She told them they did not need a warrant, invited them in, took a key, opened a garage door, and showed them where the



records were stored [R. T. 155, 1728]. The officers then transported the records to the Fresno District Attorney's Office [R. T. 1730]. When an investigation was later commenced by the United States Postal Department, the records were turned over to a postal inspector [R. T. 1724, 1738]. This investigation led to the indictment of appellant on February 26, 1964. On April 10, 1964. a motion to suppress these files as evidence was filed and subsequently denied [C. T. 48]. The motion was renewed at trial. and reheard in conjunction with a motion to dismiss for lack of due process of law [R. T. 113-187; C. T. 75, 77]. Both motions were denied, and the records were subsequently admitted into evidence as plaintiff's Exhibits 1-33. The defendant was convicted by a jury of Counts 1-8, 10-15, 17-23, and 25-29 of the indictment [R. T. 2201-02], the Government having dismissed Counts 9, 16, and 24 [R. T. 1596].

IV

ARGUMENT

A. THE TRIAL COURT DID NOT ERR IN DENYING THE APPELLANT'S MOTION TO SUPPRESS AS EVIDENCE THE CORPORATE RECORDS OF INTER-AMERICAN LOAN SERVICE.

The trial court found no need to even consider the legality of the search by which the corporate records of Inter-American Loan Service were acquired. It based its denial of the motion to



suppress solely upon a finding that the appellant had no standing to make the motion:

"I think that the distinction that must be made here is the fact that they were talking about corporate records. We do not have the corporation protesting, nor objecting, nor do we have the records being used against the corporation." [R. T. 184].

It is the position of the Government that this holding was consistent with the requirement of Rule 41(e), Federal Rules of Criminal Procedure, which provides that:

"A person aggrieved by an unlawful search and seizure may move the district court for the district in which the property was seized for the return of the property and to suppress for the use as evidence anything so obtained. . . . " (emphasis added).

Appellant seeks to qualify as a "person aggrieved" by asserting his identity with the corporation: "Appellant was IALS." (Appellant's Opening Brief, p. 11). This argument was answered by the Second Circuit Court of Appeals in Lagow v. United States.

159 F. 2d 245, 246, cert. den. 331 U.S. 858 (1946):

"When a man chooses to avail himself of the privilege of doing business as a corporation, even though he is its sole shareholder, he may not



vicariously take on the privilege of the corporation under the Fourth Amendment; documents which he could have protected from seizure, if they had been his own, may be used against him, no matter how they were obtained from the corporation. Its wrongs are not his wrongs; its immunity is not his immunity. This we have four times decided. In Re Dooley, 48 F. 2d 121, United States v. De Vasto, 52 F. 2d 26, Connolly v. Medalie, 58 F. 2d 629, United States v. Antonelli Fireworks Co., 155 F. 2d 631."

The trial court placed specific reliance upon Lagow [R. T. 185], as have other district courts in <u>United States v. Carroll</u>, 144 F. Supp. 939 (S. D. N. Y. 1956), and <u>United States v. Labovitz</u>, 20 F. R. D. 307 (D. Mass. 1957).

Appellant relies upon <u>Jones</u> v. <u>United States</u>, 362 U.S. 257, 261 (1960), for its definition of the Rule 41(e) standing requirement:

"In order to qualify as a 'person aggrieved by an unlawful search and seizure' one must have been a victim of a search or seizure, one against whom the search was directed, as distinguished from one who claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else."

Appellant then seeks to define "victim" as the one against whom



evidence was being sought. Such is not the meaning of Jones. In Jones, the defendant was "using" a friend's apartment for one night. He was charged with facilitating the concealment of narcotics after narcotics were found in a bird's nest on an awning just outside a window of the apartment. In seeking to suppress the narcotics, defendant did not, of course, allege possession or ownership of the narcotics, and the only possessory interest in the apartment consisted of his friend's permission to use it. In reversing the trial court's holding that the defendant lacked standing, the Supreme Court advanced two alternative grounds. First, it held that where possession is the basis upon which conviction is sought, the defendant will have standing without a preliminary showing of an interest in the premises searched or the property seized. In other words, where the government bases its case upon possession, it is precluded from opposing a motion to suppress on the basis of standing. 362 U.S. 263-64. Secondly, the Court found that the legally requisite interest in the premises was satisfied. It held that "anyone legitimately on premises where a search occurs may challenge its legality by way of a motion to suppress, when its fruits are proposed to be used against him". 362 U.S. at 267.

Here, unlike <u>Jones</u>, the Government's case was not based upon possession of IALS files; thus, appellant still had to show an interest either in the premises searched or the property seized.

See <u>Diaz-Rosendo</u> v. <u>United States</u>, 357 F. 2d 124 (9th Cir. 1966).

Appellant makes no claim of any interest in the premises



searched, or that he was on the premises where the search occurred. Nor can he claim an interest in the property seized. First, the separate identity of the corporation and its officers and/or shareholders must be recognized. The numerous cases holding that a corporate officer cannot refuse to produce corporate records under subpoena on the grounds of self-incrimination reinforce this distinction. See, e.g., Hyster v. United States, 338 F. 2d 182 (9th Cir. 1965); Wild v. Brewer, 329 F. 2d 924 (9th Cir. 1964); United States v. Goldberg, 330 F. 2d 30 (3rd Cir.), cert. den. 84 S. Ct. 1630 (1964), all decided since Jones. Secondly, whatever interest appellant may have had in the files was effectively transferred when a contract was entered to turn these files over to Mr. Sherief of United Lenders Service [R. T. 133-36]. The effect of this agreement can best be ascertained from the appellant's own testimony on cross-examination:

- "Q. Now, did you have any control or supervision over the manner in which Mr. Sherief would service your files?
- "A. No, I wouldn't say that I had any direct control over it, because I was out of the business."

 [R. T. 1982].

The appellant also places reliance upon decisions of the Fifth Circuit Court of Appeals, in <u>Henzel v. United States</u>, 296

F. 2d 650 (1961), and the Tenth Circuit Court of Appeals, in <u>Villano v. United States</u>, 310 F. 2d 680 (1962). The factual settings



of both of these cases, however, involved seizure from an office occupied and used by the defendant. No such interest in the premises searched is claimed by the appellant.

In Henzel, a Postal Inspector accompanied a deputy sheriff who was levying on a judgment against the corporation, and seized corporate records without a warrant. The trial judge denied a motion to suppress on grounds the defendant lacked standing. In reversing, the Fifth Circuit Court of Appeals emphasized these facts:

"In the instant case, the appellant was the organizer, sole stockholder, and president of Chemoil Corporation. Appellant prepared much of the material seized, and this material was kept in his office along with some of his personal belongings. Although he was temporarily absent from his office when it was searched, appellant spent the greater part of every average working day there." 296 F. 2d at 653.

In a subsequent case, where the issue of standing was not reached, the same court cautioned that <u>Henzel</u>, <u>supra</u>, stands on its facts. <u>Peel</u> v. <u>United States</u>, 316 F. 2d 907, 909, <u>cert. den.</u> 84 S. Ct. 174 (1963).

Similarly, Villano, supra, recognized the standing of a defendant to suppress corporate papers removed from his desk in his presence, after he had been awakened before dawn at his



residence, and taken by police to his place of business.

The importance of the factual settings of these cases was illustrated in the decision of the U. S. District Court for the District Court for the District of Maryland, in <u>United States</u> v. Culver, 224 F. Supp. 419 (1963). In denying standing to the defendants to suppress the records of a corporation which they organized and owned, the court discussed <u>Henzel</u> and distinguished it as follows:

"But there is <u>no</u> allegation or evidence that any defendant maintained his personal office in any office of SFIC or in any office of any association, or kept any of his personal papers in any such office, or was ever present when any paper was obtained by a postal inspector." 224 F. Supp. at 427.

Since the appellant claims no interest in the premises searched, and since he has no interest in the property seized, even under the broad test of <u>Jones v. United States</u>, <u>supra</u>, he does not qualify as a "person aggrieved" within the meaning of Rule 41(e). He is, rather, "one who claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else . . . ". <u>Jones v. United States</u>, 362 U.S. 257, 261 (1960).



B. APPELLANT WAS NOT DENIED DUE PROCESS OF LAW BY THE CONDUCT OF THE GOVERNMENT IN HANDLING OF THE CORPORATE FILES OF INTERAMERICAN LOAN SERVICE.

It was never made clear to the trial judge upon what basis the defendant claimed a denial of due process of law [R. T. 185]. Appellant's Opening Brief provides little further enlightenment. Except for the appellant's own vague assertion that documents were missing, there is nothing in the record to support the accusation that "all documents that were favorable to appellant were discarded" (Appellant's Opening Brief, p. 21). Quite to the contrary, the testimony of the appellant's own witnesses established the care with which these documents were handled [R. T. 1732, 1737-38]. The police chief who originally seized the files testified at trial that the files were in the same condition as at the time of seizure [R. T. 520]. On numerous occasions, appellant was given an opportunity to examine the files in the Government's possession, without benefit of a court order [R. T. 1837-39].

The Government is well aware of its obligation to make available to the defense any evidence favorable to the accused.

Brady v. Maryland, 373 U.S. 83 (1963). Such an obligation cannot be imposed, however, where the existence of such evidence, much less its possession by the Government, is not established. The Government could be ordered to do no more than it has already done: throw open its entire files for the appellant to peruse at his leisure.



CONCLUSION

There appearing no error in the rulings of the court below, the appellee respectfully prays that the judgment of conviction be affirmed.

Respectfully submitted,

MANUEL L. REAL, United States Attorney,

ROBERT L. BROSIO, Assistant U. S. Attorney, Chief, Criminal Division,

GERALD F. UELMEN, Assistant U. S. Attorney,

Attorneys for Appellee, United States of America.

. .



CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Gerald F. Uelmen
GERALD F. UELMEN



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APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

In reply, appellant will respond to the arguments made by appellee which were limited to the Trial Court's findings that he had no standing regarding his Motion to Suppress Evidence, and there was no Denial of Due Process.

Appellee does not dispute all of the other allegations made by appellant and its non-response to these allegations may be a tacit admission of their validity.

Appellant may ignore some arguments in appellee's brief when he feels that the matter was sufficiently covered in his Opening Brief.

It should be noted that appellee inserted approximately five to six pages of detailed information to set forth its Statement of Facts



and only seven pages for its entire argument. Appellant submits that the reasoning behind this "maneuver" is to tell this Court that even though the Trial Court may have committed error, the appellant was "obviously" guilty; and therefore, appellee should prevail.

Ι

THE TRIAL COURT ERRED IN DENYING APPELLANT'S MOTION TO SUPPRESS EVIDENCE.

The main difference between appellant's argument and appellee's argument is the definition of "a person aggrieved" as stated in Rule 41(e), Federal Rules of Criminal Procedure. The leading case of <u>Jones v. United States</u>, 362 U.S. 257, 261 (1960) defined Rule 41(e) as follows:

"In order to qualify as a 'person aggrieved by an unlawful search and seizure', one must have been a victim of a search or seizure, one against whom the search was directed, as distinguished from one who claims prejudice only through the use of evidence gathered as a consequence of a search or seizure directed at someone else. . . "

Jones defined "a person aggrieved" as one who was the victim of the search or seizure, one against whom the search was directed. Was appellant the victim of the search? Was he the one against whom the search was directed? Or was the search directed



against someone else, making him a consequential victim of that search?

These were the guidelines in the Jones case. Can there be any question that the search and seizure was directed against appellant and only against appellant? Chief Davis had a criminal complaint against appellant when he sought a search warrant. IALS was defunct at that time. The records obtained by Chief Davis were not directed against someone else, since there was no one else Chief Davis wanted when he picked up the records. He came to Los Angeles in order to carry out an investigation against Robert C. Hill, the appellant (R. T. 514). We repeat, "Appellant was IALS". This fact was borne out under cross-examination of appellant (R. T. 1860-1861). Even appellee admitted this fact and based its prosecution on this assumption (R. T. 102, 2045).

Appellee never states who was the victim of the search and seizure, the one against whom the search was directed! Appellee only tries to argue that appellant was not that person. If not appellant, then whom? Surely not IALS, that was not even in existence at that time. To say that appellant was not the person against whom the search was directed is to distort the Jones case and Rule 41(e) beyond the limits of reason.

Appellee relies heavily on the case of Lagow v. United

States, 159 F. 2d 245 (1946), for its authority that appellant has no
standing in his Motion to Suppress. That case was decided in 1946
while subsequent cases held that an individual who is personally
identified as the corporation could move to suppress unlawfully



seized evidence even though it was allegedly in the name of the corporation, Henzel v. United States, 296 F. 2d 650 (5th Cir. 1261); Villano v. United States, 310 F. 2d 680 (1962). The Lagow case was a very brief opinion and it did not state if the defendant was the president, director, officer, organizer or operator of the corporation. The Henzel case did bring out these facts and then ruled that the defendant could suppress evidence consisting of corporate records that were obtained by unlawful search and seizure.

Appellee attempts to distinguish the Henzel and Villano cases with the present case by stating that the factual situations were different. Although one should examine the factual situations of each case before citing them, it does not mean that the two cases must have an identical factual situation before the law is applicable, as very few cases have identical facts.

Appellee attempts to refute the Henzel case with Peel v.

United States, 316 F. 2d 907 and United States v. Culver, 224

F. Supp. 419 (1963), which is a Trial Court case. In the Peel case, the Court held that a Subpoena Duces Tecum was valid against a corporation and that defendants could not object if the corporation records were turned over to the United States for prosecution. The Court took pains to mention that defendants were not officers or directors of the corporation when its records were subpoenaed.

With regard to the separate identity of a corporation, appellee argues on Page 12 of Appellee's Brief:

"First, the separate identity of the corporation and its officers and/or shareholders must be recognized.



The numerous cases holding that a corporate officer cannot refuse to produce corporate records under subpoena on the grounds of self-incrimination reinforce this distinction. See, e.g., Hyster v. United States, 338 F. 2d 182 (9th Cir. 1965); Wild v. Brewer, 329 F. 2d 924 (9th Cir. 1964); United States v. Goldberg, 330 F. 2d 330 (3rd Cir.), cert den. 84 S. Ct. 1630 (1964), all decided since Jones."

Appellant does not contend one way or another that a <u>valid</u> <u>subpoena duces tecum</u> for corporate records can be suppressed by an officer of the corporation since this is not the issue of the present case. Appellee talks about a valid subpoena duces tecum of an existing corporation. The facts in the present case concern an unlawful search and seizure of a defunct corporation that never really existed.

Suppose there was an unlawful search and seizure of a valid existing corporation. How could it object? Is it a living being?

The cases of Silverthorne Lumber Co. v. United States of America.

251 U.S. 385, 40 S. Ct. 182, 64 L. ed. 319, 24 A. L. R. 1426 and Henzel v. United States, supra, stated that a corporation has the same rights as a natural person to be free from illegal search and seizure. The only way to protect this right is through its officers. In this case, appellant was the president, officer, organizer, and sole operator of his business. What better person to object on behalf of the corporation? In either situation, the Motion to



Suppress should have been sustained, since the unlawful search and seizure was directed against appellant as an individual or against IALS as a corporation, and appellant could object on behalf of the corporation. Appellee tries to refute this argument by taking a question and answer out of context (Appellee's Argument, Page 12) and stating that the appellant transferred all of his interest in the files to Mr. Sherief. If appellee read a little further, it would have discovered:

"Q. After you turned over the files to Mr. Sherif, did the files then belong to Mr. Sherif?

"A. No, I wouldn't say that they belong to Mr. Sherif. They belonged to me. They were given to Mr. Sherif to continue working on." (R. T. 1984).

Appellant further testified that Mr. Sherief had limited authority over the files and that they were subsequently taken from Mr. Sherief to the home of Mrs. Leland Hill where appellant examined them and found them intact (R. T. 126, 128, 129, 134, 135).

II

APPELLANT WAS DENIED DUE PROCESS OF LAW

It is contended by appellee that the seized documents were handled with care, as stated by former Deputy District Attorney



Michael Kershaw of Fresno County (R. T. 1732, 1737, 1738) and that Chief Davis testified that the files were in the same condition at the time of trial as when he seized them (R. T. 520).

Mr. Kershaw stated that the files were placed in various offices for storage (R. T. 1730) and that he left his employment in 1960 (R. T. 1723), so how could he state that none were lost or discarded? As for Chief Davis, he admits that he knew nothing of the files after they were stored at the District Attorney's Office (R. T. 521). What evidence did the United States produce to counter appellant's sworn statement that many documents were missing when he examined the folders on January 8, 1965? The United States did not produce one witness to testify that the files remained intact during the four years that they were in the government's possession (R. T. 511). Not one shred of evidence to indicate where the files were stored or who had possession of them! If appellee did not believe appellant's sworn statement, why didn't it attempt to prove him wrong? The only attempt was made by Chief Davis, who stated:

"Q. Just now, for illustration, please, Chief, I show you a file here and if you will look at it, please, sir, and tell us in the main, if when you went through the files that you took under and by means of the search warrant and otherwise, you saw other papers other than the papers that you see in that file? Now, I mean not by identity, but others, meaning looking different.

"A. Well, as I say, this has been so long ago,
I -- at that time, I wasn't too much interested in this



thing, of really making this stick with me, but as I recall, this looks like the way that most of the files were." (R. T. 519-520).

Later on, while still under cross-examination, Chief Davis stated:

- "Q. Well, did the inventory show how many files were in the boxes, each box?
- "A. Well the most of the inventory was actually done by Mr. Kershaw and one of the other deputy district attorneys. I was just in and out of the--because I was performing my duties at my department and still working with the D. A. 's office, which is a period of twenty miles distance, and I was back and forth between the two offices, as I could find time.
- "Q. Well, Chief, are you then saying you don't know?
- "A. Well, that is just about it, to be honest with you." (R. T. 521).

Appellee states that it had "throw (sic) open its entire files for the appellant to peruse at his leisure". When? Ten days before the trial!



Appellee's actions were a flagrant disregard for appellant's Due Process of Law since appellant's sworn affidavit stated that documents necessary to his defense were missing while in the hands of the authorities and his attorney could not prepare a defense to the charges against him without these documents (C. T. 64, 75).

Respectfully submitted,

JACK HADDAD

Attorney for Appellant



CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Jack Haddad JACK HADDAD



No. 20944 /

In the

United States Court of Appeals

For the Ninth Circuit

HARRY P. LOCKLIN and ELMER J. BRANT, general partners doing business under the firm name of Radiant Color Company,

Plaintiffs-Appellants,

VS.

SWITZER BROTHERS, INC.,

Defendant-Appellee.

Appellants' Opening Brief

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ABBREVIATIONS USED IN APPELLANTS' OPENING BRIEF

"Radiant" refers to Harry P. Locklin and Elmer J. Brant, general partners doing business under the firm name of Radiant Color Company, Plaintiffs-Appellants.

"Switzer" refers to Switzer Brothers, Inc., Defendant-Appellee.

The record references (CT....) refer to the pagination of the clerk's transcript filed on this Appeal No. 20,944.

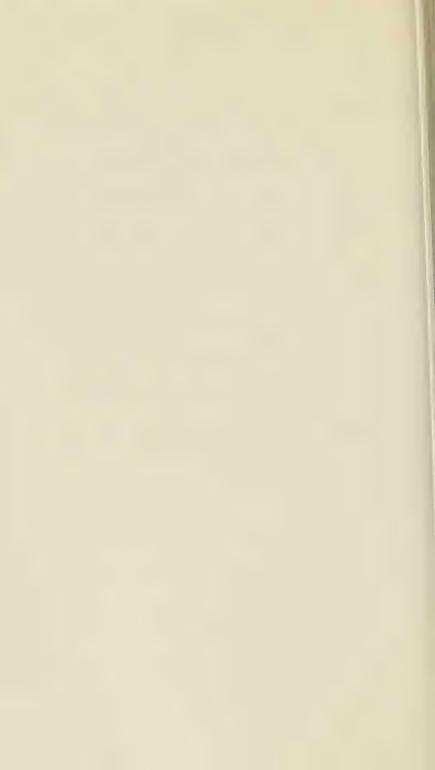
The record references (RT....) refer to pagination of the reporter's transcript on the contempt hearings.

The record references (OR....) refer to pagination of the printed record on the original Appeal No. 16,780.

The references to Exhibits S-.... and Dcx S-.... refer to exhibits identified by Switzer in the contempt hearing.

The references to Exhibits R-.... and Pcx R-.... refer to exhibits identified by Radiant in the contempt hearing.

The "7-4-1" resins refer to various test resins made by the parties with 7 moles of formaldehyde, 4 moles of toluene-sulfonamide, and 1 mole of melamine.



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Plaintiffs-Appellants,

VS.

SWITZER BROTHERS, INC.,

Defendant-Appellee.

Appellants' Opening Brief

This is an appeal from an order (a) holding Radiant in civil contempt for violating an injunction against infringement of the Kazenas patent owned by Switzer; (b) enjoining and restraining Radiant from manufacturing, using, selling or offering for sale "Radiant's 4-C series fluorescent resins and pigments and all other fluorescent pigments equivalent in relation to the patent in suit to the original fluorescent pigments previously adjudicated" to infringe and (c) requiring Radiant to account to Switzer for damages.

JURISDICTION

Jurisdiction of the District Court is based upon U. S. Code, Title 28, Section 1338(a), the underlying action having arisen under the patent laws of the United States.

Jurisdiction of this Court is based upon U. S. Code, Title 28, Section 1292(1) and 1292(4), this appeal being taken from an order which is both (a) an interlocutory order of the District Court granting or modifying an injunction and (b) a judgment in a civil action for patent infringement which is now final except

for accounting. The judgment was entered on March 30, 1966 (CT 121), and the notice of appeal was filed April 4, 1966 (CT 127), within the 30-day period provided by U. S. Code, Title 28, Section 2107.

STATEMENT OF THE CASE

Chronology of proceedings

The present proceedings are a sequel to an earlier trial in which the District Court held that Claims 1, 2, 3, 4 and 9 of the Kazenas patent were valid and that Radiant infringed said claims in its manufacture, use, sale and offer for sale of "Velva-Glo" fluorescent pigments (CT 30). This earlier judgment was affirmed in Locklin v. Switzer Brothers, Inc. (9 Cir. 1961), 299 F.2d 160. The Supreme Court denied certiorari as well as rehearing (369 U.S. 861, 891).

On May 2, 1962, the District Court issued a writ of perpetual injunction, pursuant to the mandate of this Court, permanently restraining and enjoining Radiant from directly or indirectly making, using, selling or offering for sale, except under license from Switzer, any fluorescent pigment embodying or manufactured by the use of the inventions disclosed and claimed in Claims 1, 2, 3, 4 and 9 of the Kazenas patent or in any other way infringing upon said claims. (CT 35).

On May 8, 1963, Switzer filed a petition for an order adjudicating Radiant in civil contempt for violation of the judgment and the injunction by its manufacture and sale of the now accused pigments identified generally as Radiant's 4-C series fluorescent pigments (CT 40). In a memorandum of decision filed March 31, 1964, the District Court concluded on the basis of affidavits that Radiant violated its writ of perpetual injunction. Upon appeal from the formal order (CT 103), this Court remanded the case to the District Court with directions that trial be had upon the sole question whether, in the 4-C resin, the amount of melamine utilized is such as to bring the resin within the limits of the claims of the Kazenas patent as those claims are delineated in the former opinion of this Court (CT 106 and 348 F.2d 244).

After remand, the District Court held an evidentiary hearing on the above question from October 11, 1965 to October 15.

the District Court again concluded that Radiant violated its written of perpetual injunction. The Court below held that the amount of melamine utilized in the 4-C pigment was within the limits of the claims of the Kazenas patent as those claims are delineated in Locklin v. Switzer Brothers, Inc. (9 Cir. 1961) 299 F.2d 160 (CT 119). This appeal from the formal judgment entered March 30, 1966 (CT 121) followed on April 4, 1966 (CT 127).

Statement of factual background and issues

The Kazenas patent relates to a thermoplastic melamine-sulfon-amide-formaldehyde resin which is capable of being finely ground and "which remains insoluble without agglomeration in aromatic hydrocarbon solvents" (299 F.2d 162-163). Claim 2 is typical of the claims involved in this appeal (299 F.2d 163). Claim 2 sprovides, element by element:

"A completely condensed, thermoplastic resin consisting essentially of the condensation product of

at least one aldehyde component entirely selected from the class consisting of formaldehyde and paraformaldehyde,

at least one aromatic monosulfonamide having two reactive amide hydrogens, where the sulfonamide group is attached directly to the aromatic nucleus through the sulfur atom,

and at least one melamine compound selected from the class consisting of melamine, alkyl melamines having no more than one alkyl substituted amido nitrogen, and monohydric alkanol modified methylol and alkyl methylol melamines, the amount of said melamine compound being an amount, not exceeding 50% by weight of the aromatic monosulfonamide.

sufficient to render said condensation product substantially insoluble in aromatic hydrocarbon solvents

but insufficient to render it thermosetting."

The accused 4-C pigment, like the resins which were found to infringe the Kazenas patent in the first appeal, is thermoplastic and contains the aldehyde, sulfonamide and melamine components of the claims. Radiant contends that the amount of melamine compound embodied in the manufacture of the accused pigment is not within the critical limits of the claims of the Kazenas patent as those claims are delineated in *Locklin v. Switzer Brothers, Inc.*, 348 F.2d 244, e.g. that the accused pigments do not contain an amount of melamine compound "sufficient to render the condensation product substantially insoluble in aromatic hydrocarbon solvents".

Radiant made essentially the same basic argument on the first contempt appeal. The question raised on that appeal was whether the Kazenas patent covered resins which were rendered substantially insoluble by melamine plus the additional ingredient urea, rather than melamine alone. Radiant successfully urged that the patent covered only the latter types of resins and not those which were rendered "substantially insoluble in aromatic hydrocarbon solvents" by melamine plus the additional ingredient. Switzer argued that the proper test was whether or not the amount of melamine utilized by Radiant was within the area covered by the examples of the Kazenas patent, and that it was merely a question of whether the 4-C resin is equivalent to the infringing resin to which the injunction was directed. This Court rejected Switzer's contentions and held (348 F.2d 246):

". . . In our judgment if appellants' contentions are factually correct there would be no infringement. In our earlier opinion we ruled that the use of this functional language in specifying the amount of melamine required (an amount sufficient to render the condensation product substantially insoluble in aromatic hydrocarbon solvents, but insufficient to render it thermo-setting) did not invalidate the claims, but by the same token it served to fix precisely the limits of the claims."

This appeal probes the experiments and other circumstances upon which the District Court relied to conclude that the accused 4-C pigments do contain melamine in an amount sufficient to render the product substantially insoluble in aromatic hydrocarbon solvents. Radiant contends that the experiments and tests upon which the District Court relied in the contempt trial do not prove that these pigments contain sufficient melamine to bring the resin

within the limits of the claims as those claims are delineated in this Court's earlier opinion. Radiant also contends that certain of Switzer's tests as well as Radiant's own tests conclusively prove that the accused pigments do not utilize melamine in an amount sufficient to infringe the claims.

Questions presented

On this appeal, Radiant presents two questions:

- 1. Did Switzer prove that the accused pigments infringe the Kazenas patent by providing an amount of melamine sufficient to render the resin of the pigment substantially insoluble in aromatic hydrocarbon solvents as those claims were delineated in this Court's opinion on the first appeal?
- 2. Notwithstanding this Court's decision on the first appeal, in view of the new circumstances brought out on the contempt thearing and the intervening case law, do the claims of the Kazenas patent truly comply with U. S. Code, Title 35, Section 112?
- Both of these questions, Radiant submits, should be answered in the negative.

SPECIFICATION OF ERRORS

Pursuant to Rule 18(d) of this Court, Radiant urges that the District Court erred:

- 1. When it failed to find that tests made with Radiant's inter-partes test resin produced on September 2, 1965 proved that the accused pigment is *not* one which will remain free flowing in either of the aromatic hydrocarbon solvents benzene or toluene;
- 2. When it failed to find that the tests of Radiant's interpartes test resin produced on September 2, 1965 in a regular batch or production run using the same raw material and quantities as used in the manufacture of accused pigments is the most accurate test for determining the functional behavior of the three resential ingredients in the accused pigments;
- 3. When it failed to find that Radiant's inter-partes test resin produced on September 2, 1965 was made by taking the same three essential ingredients as those used in the typical ac-

cused pigment and reacting them in the absence of urea, the oxalic acid and the dyestuff, but otherwise in the same manner in which Radiant made the accused pigment commercially;

- 4. When it failed to find that Radiant's inter-partes test resin produced on September 2, 1965 was made by using comparable paratoluene sulfonamide, the same paraformaldehyde, and the same melamine as Radiant used in the manufacture of the accused pigment;
- 5. When it failed to find that the tests made with Radiant's inter-partes test resin produced on September 2, 1965 are confirmed by some earlier tests made by Switzer where the 7-4-1 resin agglomerated in benzene in one week;
- 6. When it failed to find that the probative value of tests made on Radiant's inter-partes test resin produced on September 2, 1965 is further confirmed by the contrary results obtained in testing a laboratory resin made by Switzer using a different kind of melamine ingredient (having a pH nine times more acidic than that used in the manufacture of accused pigments), and different time-temperature procedures;
- 7. When it gave weight to defendant's exhibits S-6 through S-8 and S-22 through S-27 as showing the insolubility characteristics of the accused pigment and the patented resin.
- 8. When it found that there was "no merit in Radiant's contention that the results (of Switzer's inter-partes tests) are not reliable because of certain differences between the kind of melamine Switzer used in its qualitative tests and that used by Radiant, and because of certain differences in the method of preparation of the test resin by Switzer" (CT 115);
- 9. When it found that "the benzene test conducted by Radiant, showing its JS-738 resin to have agglomerated in benzene after approximately seven weeks, does not disprove that the accused resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 115 and 119);
- 10. When it failed to find that patented resins must be insoluble in all aromatic hydrocarbon solvents, rather than one or some hydrocarbon solvents;

- 11. When it failed to find that the patented resin must remain free flowing in aromatic hydrocarbon solvents without agglomeration for a substantial period of time and at least as long as four months:
- 12. When it found that "at the original trial, the lapse of time between the date when the resin was placed in toluene and the date when the observations of the condition of the resin in the toluene were made, was less than one week" (CT 112);
- 13. When it found that "when taken together, the 24 hour and 17 day qualitative test conducted by Switzer, and the qualitative tests conducted by Radiant which show that their JS-738 resin was free flowing and dispersed in toluene and xylene after approximately seven weeks, are simple clear reliable tests, which demonstrate that . . . the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 115);
- 14. When it found that "the above tests when considered together . . . show beyond any doubt that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 115-116);
- 15. When it found that "the results of the quantitative tests (conducted by Switzer) with the JS-738 resin substantiate the findings . . . with regard to the qualitative tests, to wit: that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (CT 117);
- 16. When it failed to find that Switzer's quantitative tests for determining substantial insolubility should be rejected because such 24-hour tests are not significant in determining the ultimate issue of whether the amount of melamine used in the manufacture of a resin is sufficient to render the resin substantially insoluble in aromatic hydrocarbon solvents;
- 17. When it failed to find that quantitative tests for determining the substantial insolubility of a resin in aromatic hydrocarbon solvents are indefinite and do not serve to distinguish over the prior art Japanese resin;
 - 18. When it failed to find that none of the experts testifying

at trial could attach a numerical value to the term "substantially insoluble" for purposes of establishing a quantitative test;

- 19. When it failed to find that there is no known relationship between quantitative solubility and a determination of whether a resin is either "substantially insoluble" or will remain free flowing and not agglomerate;
- 20. When it failed to find that the only tests made in this record to show the time required for M-S-F resins to attain equilibrium in solution demonstrates that equilibrium is not reached in 24 hours;
- 21. When it found that the record indicates that "the additional urea, itself, has little or no effect in producing substantial insolubility" (CT 117);
- 22. When it found that "the agglomeration of the JS-739 resin (with urea) in benzene after approximately seven weeks demonstrates that the addition of urea had no apparent effect on the 4-C resin" (CT 119);
- 23. When it found that "the amount of melamine by itself in the accused 4-C resin is sufficient to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 117);
- 24. When it found that "the amount of melamine utilized (in the 4-C resin) is such as to bring the resin within the limits of the claims of the Kazenas patent as those claims are delineated in *Locklin v. Switzer Bros., Inc.,* 299 F.2d 160 (9th Cir. 1961)" (CT 119);
- 25. When it failed to dismiss defendant's petition for Order Adjudicating Respondents, Harry P. Locklin and Elmer J. Brant, in Civil Contempt for Violation of Judgment and Injunction.

ARGUMENT

THE CONTEMPT ORDER SHOULD BE REVERSED BECAUSE RADIANT DOES NOT INFRINGE THE KAZENAS CLAIMS

Preliminary discussion of evidence on the first question

The accused pigment is generally referred to in this brief and in the record below as the "4-C" pigment. This pigment is exemplified by formula sheet 5782 dated February 24, 1963 (Pcx R-1, RT 331, 340-341).

This exemplar of the accused pigment called "CHART 4C R-104" was made with the following raw materials and amounts:

Paratoluene sulfonamide	381 lbs.	
Buffered melamine	70 lbs.	8 oz.
Paraformaldehyde	117 lbs.	8 oz.
Urea	16 lbs.	12 oz.
Dyestuff	12 lbs.	
Oxalic acid (411 grams)	1	14.4 oz.

The total mass of the raw materials was, thus, 598 pounds, 10.4 ounces. The raw materials were mixed in a large metal vat and heated in an oil bath for a total time of two hours, ten minutes (Pcx R-1, RT 346-349). After the dyed resin was finished, it was cooled and ground into pigment particles (RT 350-351).

In preparation for trial of the contempt issues, Radiant and Switzer made experimental test resins and conducted experiments to determine whether or not the accused 4-C pigment contained sufficient melamine compound to fulfill the functional limits of the claims. Each test resin used the three essential ingredients (melamine, sulfonamide and formaldehyde) of the patented resin but in the same 7-4-1 molar proportions as used in the manufacture of the accused pigment. Ingredients of the accused pigment other than the three essential ingredients were eliminated to isolate the "insolubility" effects produced by melamine apart from other ingredients, such as the urea, dye and oxalic acid of the accused pigment.

The Gray test resin

In order to prove that the accused pigment met the requirements of the claims, Thomas J. Gray, house counsel for Switzer and an experienced chemist, conducted an inter-partes experiment in which he produced a resin (Dcx S-5), which Switzer has called the 7-4-1 resin, using the following raw materials and proportions (RT 123; Dcx S-1, S-2, S-3, S-4 and S-9):

Ortho and paratoluene sulfonamide	342.4	grams
Paraformaldehyde	105.1	grams
Recrystallized melamine	63.05	grams

The total mass of ingredients was thus 510.55 grams or 1 pound, 1.9 oz. These materials were placed in a quart metal can, were stirred and were heated by means of an oil bath (RT 123-124). The material was then dumped, permitted to cool and was ground to obtain the ground resin of Exhibit S-5 (RT 124). This resin is usually referred to in this brief as the Gray test resin. Switzer used the Gray test resin in conducting certain of the solubility experiments upon which the District Court relied in its memorandum opinion.

The Gray test resin used the same molecular proportions of formaldehyde (7 moles), sulfonamide (4 moles), and melamine (1 mole) as those which were used in the accused pigment but it differed from the accused pigment in the following respects:

- 1. The Gray resin, quite properly, did not incorporate the urea, dyestuff, or oxalic acid of the accused pigments (Dcx S-9).
- 2. It substituted a recrystallized melamine for the buffered melamine used in the accused pigment (RT 130-131, 423-424, 596-597).
- 3. It substituted a mixed ortho- and paratoluene sulfonamide for the straight paratoluene sulfonamide used in the accused pigment (RT 129, 131-132, 591).
- 4. The ingredients were reacted in a different time-temperature relationship from that used to make the accused pigment (RT 424-425, 596-605).
- 5. The reaction mass of the Gray test resin (1 pound, 1.9 oz.) was but a minute fraction (0.19%) of the reaction mass of the accused pigment (598 pounds, 10.4 oz.).

We later argue that the Gray test resin has no probative value in assessing the behavior of the melamine, sulfonamide, and aldehyde components in the accused pigment.

The Wayne test resin

In order to prove that the accused pigment did not incorporate the melamine, sulfonamide and aldehyde components in the proportions called for in the claims, Radiant conducted an inter partes batch experiment in which it reacted the raw materials in the same vessel and following the same procedures as used in producing the accused pigments (Pcx R-2; RT 332, 333, 346-349, 359-361). The raw materials and proportions used in the experiment were:

paratoluene sulfonamide	381 lbs.	
paraformaldehyde	117 lbs.	8 oz.
buffered melamine	70 lbs.	8 oz.

As in the case of the accused pigments, the reacted mass was permitted to cool and was ground into a powdered resin (RT 348, 350). This resin is hereinafter usually referred to as the Wayne test resin. Both Radiant and Switzer performed solubility experiments on this test resin (Pcx R-7; R-8; R-9 and R-10; Dcx S-33; S-34; and S-35; RT 202-205, 373-390). The District Court did not refer to these experiments nor to the Wayne resin itself in its opinion.

The Wayne resin was identical with the accused pigment with the single exception that it did not have the urea, dye stuff, or oxalic acid used in the accused pigment (RT 333; Pcx R-2). It compared with the accused pigment and the Gray resin in the following respects:

- 1. The accused pigment and the Wayne resin used substantially the same reaction mass—the Gray resin used a much smaller reaction mass.
- 2. The accused pigment and the Wayne resin were both made with buffered melamine (RT 363-364)—the Gray resin was made with recrystalized melamine (RT 130, 423-424).
- 3. The reaction in the Gray resin had a different time-temperature reaction than that used to make the accused pigment and the Wayne resin (RT 596-597).

We later argue that Radiant should have been able to rely on experiments conducted upon this Wayne test resin to determine whether or not the accused pigment comes within the scope of the Kazenas claims.

The Bennahmias test resin

Radiant also conducted an inter partes laboratory experiment using limited quantities of the essential raw materials to confirm (a) the results of its batch experiment and (b) the earlier results

of experiments which were made for the original contempt proceeding on a resin designated as JS-738. The raw materials and proportions used in the laboratory experiment were the same as those used to produce the Wayne test resin with the exception that the batches of formaldehyde and melamine were different. The ingredients, however, were the same as those used in some production runs (RT 411-412). This resin (Pcx R-16) is hereinafter usually referred to as the Bennahmias test resin and it was used in connection with solubility experiments (Pcx R-17, R-18 and R-19) referred to later in this brief.

The Bennahmias test resin has also been referred to in the record and in the District Court's Memorandum of Decision as a JS 738 resin. Therefore, the Court should be mindful that there are actually two JS 738 resins referred to in the record. The first JS 738 resin was made by Mr. Bennahmias in 1963, and that resin was used for conducting solubility tests that formed the basis of the earlier contempt appeal. The second JS 738 is Bennahmias test resin R-16, which was made during the interpartes test on September 3, 1965.

The discussion thus far in this argument is largely expository of the experiments which the parties conducted and Radiant believes that the matters thus far discussed are without substantial dispute. The issues presented by question 1 relate to the contentions which the parties made and which are based upon such experiments and their probative effect upon the issues presented for adjudication. With this general discussion of the evidence, we now turn to specific issues and show that—

Rule 52(a) does not control the issues on this appeal

In arguing reversible error upon the merits of the contempt judgment, we must first face the effect of Rule 52(a) of the Federal Rules of Civil Procedure on the issues under review. That rule provides that "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." It will appear that the issues presented on this contempt appeal do not depend so much upon credibility of wit-

nesses as they do upon the construction of the Kazenas patent claims and the earlier decision of this Court. We urge that "the issue for decision is legal rather than factual," as it was in *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.* (7 Cir. 1952), 196 F.2d 103 and that accordingly Rule 52(a) is not really germane to the present appeal.

As stated in *United States v. Parke*, *Davis & Co.*, (1960), 362 U.S. 29, 44:

"... Because of the nature of the District Court's error we are reviewing a question of law, namely, whether the District Court applied the proper standard to essentially undisputed facts...."

More recently, in *United States v. General Motors Corp.* (1966), U.S., 16 L. ed 2d 415, the Court in an opinion delivered by Mr. Justice Fortas, stated (16 L. ed 2d at page 424, footnote 16):

"In any event, we resort to the record not to contradict the trial court's findings of *fact*, as distinguished from its conclusory 'findings,' but to supplement the court's factual findings and to assist us in determining whether they support the court's ultimate legal conclusion that there was no conspiracy."

In considering the sufficiency of the evidence to support the contempt judgment, it is important that the burden of proof of establishing violation of the injunction is upon Switzer and that Radiant is entitled to the benefit of any reasonable doubt. This is established by cases such as *Hanley v. Pacific Live Stock Co.* (9 Cir. 1916), 234 Fed. 522 at page 531; and *Schauffler v. Local* 1291, *Internat'l Longshoremen's Ass'n* (3 Cir. 1961), 292 F.2d 182 at page 189.

The District Court erred in its choice of test resins

This portion of the argument is directed to specifications of error 1 through 8, both inclusive. In general, the error which Radiant asserts in each of these specifications turns upon the nature of the experiment which a member of the public is required to make to determine whether he is within or without the boundary line defined by the Kazenas claims.

Radiant's Wayne test resin R-7, upon which Radiant principally relies as showing the effects of melamine in the accused 4-C pigment, used the same raw materials and in the same quantities as used in the manufacture of the typical accused pigment (Pcx R-1, R-2). Importantly, Radiant used the same melamine as it used in the manufacture of accused pigments (RT 363-364), and the ingredients were reacted in exactly the same manner, following the same procedures and using the same equipment as in the commercial manufacture of the accused pigment (RT 332-335).

Radiant conducted solubility tests with the resin by placing portions of the test resin in jars with various aromatic hydrocarbon solvents, namely, benzene, toluene and xylene (RT 379-380; 385-389). At the time of trial, approximately six or seven weeks later, inspection of the jars containing the Wayne test resin R-7 in benzene showed complete agglomeration (RT 381-382; CT 113). Mr. Bennahmias testified that the Wayne test resin agglomerated in benzene after the second day (RT 445). Although the Wayne test resin was free flowing in toluene at the time of trial, there was some agglomeration (RT 386). Mr. Bennahmias predicted that the resin would be completely agglomerated in a year (RT 387-388). Radiant contends that these tests clearly demonstrate that Wayne test resin R-7, and consequently the accused 4-C pigment, do not contain the amount of melamine compound as required by the Kazenas patent.

Switzer's laboratory experiment Gray test resin was prepared by reacting the three essential ingredients of the patented Kazenas resin together, but in the molar proportions of Radiant's accused 4-C pigments (Dcx S-5 and S-9). However, the resin was not made in a batch quantity like Radiant's interpartes test resin R-7. Switzer's resin was prepared in a quart metal can using laboratory equipment (RT 123-124). Furthermore, Switzer's test resin was made using a different kind of melamine ingredient than that used in the manufacture of the accused pigment (RT 132); and that melamine ingredient (recrystallized melamine) had a pH nine times more acidic than the melamine compound used in the manufacture of the accused pigments (RT 595). Although Switzer's melamine ingredient corresponds with the definition of a

melamine compound as that term is used in the Kazenas patent, it is chemically different than Radiant's melamine and the two are different compounds (RT 596).

At the time Switzer made the Gray test resin S-5, it knew that the melamine it had selected for making the resin was different from that used by Radiant in the accused pigment (RT 132). When Switzer made its arbitrary selection of recrystallized melamine, it even had on hand the precise melamine compound Radiant used in the manufacture of accused pigment and test resins (RT 645).

The purity of ingredients and mass of reaction should not have been disregarded

On the first appeal, Switzer had firmly established that differences in purity of ingredients and mass of reaction were important elements which could not be disregarded in appraising the significance of chemical experiments. When it was important for Switzer to cast doubt upon the reliability of certain experiments conducted by Mr. Paulsen on the original trial, Switzer brought this out quite clearly in its examination of Dr. Hatcher (OR 405-406):

"Q. Now, Dr. Hatcher, how difficult is it for a chemist to repeat an amide condensation and obtain the same results time and again?

"A. Once the procedure has been standardized it can be

done with ease.

"Q. Would the results be identical each time?

"A. Not entirely. They could vary in slight manner, but

they would not be altered by any large amount.

"Q. Now, how difficult is it to repeat an amide condensation and obtain different results, particularly if you want to obtain different results? [162]

"A. That naturally would not be difficult at all.
"Q. What sort of hidden variables are there?

"A. There are many hidden variables. There are the rate of heating, the mass to reaction temperature, there is the rate of cooling, the length of time held at reaction temperature. Besides, the batch has a great effect in some cases. There is the ingredients used; the purity of the ingredients used can have considerable effect. The variables are numerous."

Here Dr. Hatcher quite specifically referred to the effect of the batch and the purity of ingredients. The Wayne test resin eliminated these variables—the Gray test resin capitalized upon them.

With regard to the hidden variables arising from the precise nature of the ingredients and the mass of reaction, Switzer's expert, Dr. von Fischer, frankly agreed that slight differences in the precise nature of the ingredients can cause a difference in result (RT 299) and frankly admitted that it was difficult to make comparisons between a plant production and a laboratory production (RT 646).

Dr. Huber also testified without dispute on this point (RT 629-630):

"Q. Now, you were asked whether in your opinion a determination of how the three ingredients had to be made, had to be made in the commercial sized batch. I will rephrase that question and ask you what gives a more accurate control to determine how resin ingredients work in a batch operation, is it if you compare it with the same mass and time in a batch operation or is it if you compare it with a minute quantity of ingredients in a laboratory operation?

"A. Obviously the former, namely, the same mass and

time that is commercially used.

"Q. Now, in your experience as a chemist, have you noted whether production operations in the manufacture of resins are readily predictible only from a laboratory analysis?

"A. I would say unequivocably no. At least I have never

come across such a situation."

Moreover, it is inherent in this Court's decision upholding definiteness and particularity of the claims that any testing would have to be done with the particular melamine compound which was under consideration and not with some other melamine compound. This follows from two portions of the Court's opinion.

The first portion is that this Court accepted Switzer's representations of "the fact that of the considerable number of melamine compounds encompassed by the patent, each has a different critical limit." and that "The critical point remains the same for each melamine compound used." (299 F.2d 165, 166). Certainly when a patent is sustained on the representation that there is a different critical point for each melamine compound, any probative experi-

ment should use the same melamine compound as that which is used in the accused pigment.

In this connection, *Minerals Separation*, *Ltd. v. Hyde* (1916) 242 U.S. 261, upon which this Court relied (299 F.2d 166), would not justify any expansion of the field of inquiry beyond the ingredients actually used in the accused product, The Court there pointed out, page 271, that "The composition of ores varies infinitely, each one presenting its special problem, . . ."

There, the patent specification clearly states (214 Fed. 101):

"The proportion of mineral which floats in the form of froth varies considerably with different ores, and different oily substances, and, before utilizing the facts above mentioned in the concentration of any particular ore, a simple preliminary test is necessary to determine which oily substance yields the proportion of froth or scum desired."

Similarly, the composition of melamine compounds varies infinitely, each one presenting its special problem. The tests should be related to the particular ingredients being accused in the infringing procedure, not to some other ingredients.

This factor was one which Switzer certified in its brief on Appeal No. 16,780. Switzer there said, page 51:

"... At most, if a subsequent worker in the field wished to determine the minimum amount of some particular melamine component for imparting insolubility to the resin, it would require only a simple test. The same simple test can be used to determine whether a given resin, otherwise responding to the terms of the Kazenas patent, infringes. No experimentation is required." (emphasis added).

The second portion making it mandatory to use the specific melamine compound in testing for the critical limits of the claims is that Switzer persuaded the Court that all that was involved was "a simple, clear test for an ordinary chemist to perform and one which does not require extensive experimentation in order that the precise critical limits be ascertained in a particular case." What test could, we ask, be more simple and clear for an ordinary chemist to perform than a test with the precise ingredients which are accused to infringe? It is not sound, and it would conflict with the earlier opinion, to require that a chemist should conduct ex-

tensive experimentation with hypothetical raw materials to find out what the results would be if he were analyzing a hypothetical pigment rather than the actual pigment which was accused as an infringement. The use of different materials at best could give only a hypothetical answer to a hypothetical problem not facing the ordinary chemist when he was asked to perform the simple clear test required to sustain the Kazenas patent.

The time-temperature relationships are important

Aside from the mass of the reaction mixture and the particular melamine compound utilized, a comparison of the time temperature charts made during the manufacture of the Radiant Wayne resin and the Gray test resin clearly illustrates that a different type of reaction occurred during their manufacture (Pcx R-2; Dcx S-9, RT 590). The temperature of the oil used to heat the Wayne test resin was at all times above the temperature of the reaction mixture (RT 597), whereas the temperature of the oil used to make the Gray test resin was below the temperature of the reaction mixture for a substantial proportion of the production time, e.g., a period of 55 minutes out of a total production time of 85 minutes (RT 133). Dr. Hatcher, in his earlier testimony criticizing the experiments of Mr. Paulsen, pointed out that the rate of heating, the mass to reaction temperature, the rate of cooling and the length of time held at reaction temperature are hidden variables in an amide condensation (OR 406). Radiant's Wayne test resin eliminated these hidden variables—the Gray test resin applied them to reach the entirely different result which Dr. Hatcher must have had in mind in his earlier testimony.

The Gray laboratory test resin should have been rejected

The effect of variables in the lab experiments conducted by Mr. Gray is shown by his actual experiences with the ingredients which he selected. Mr. Gray actually made "maybe a dozen or a dozen and a half tests" in the preparation of his so-called 7-4-1 resin prior to the experiment in which he made the Gray test resin S-5 (RT 136). Some of these resins were tested for qualitative solubility in aromatic hydrocarbon solvents and agglomerated in benzene within one week (RT 137). To the direct contrary, the Gray

test resin had not even agglomerated at the time of trial, some seventeen days after the Gray test resin was deposited in benzene (RT 194). Such diversity of results cannot meet the standards laid down by this Court in response to Switzer's earlier representation that infringement could be ascertained by "a simple, clear test for an ordinary chemist to perform and one which does not require extensive experimentation . . ." (299 F.2d 166).

The Bennahmias laboratory tests confirmed non-infringement

The reliability of the Wayne test resin R-7 and the test showing it to have agglomerated in benzene at the time of trial is substantiated by the Bennahmias test resin R-16. That resin was made in Radiant's laboratory using the three essential ingredients of the Kazenas patent but in the same 7-4-1 molar proportions of the accused pigment (RT 410, 413). Moreover, the grades and kinds of ingredients were essentially the same as those used in manufacturing the accused pigments (RT 411-412). Solubility tests were then conducted by placing small amounts of the powdered resin in test tubes with the aromatic hydrocarbon solvents benzene, toluene and xylene (RT 415). At the time of trial, the test in benzene (Pcx R-17) was completely agglomerated (RT 417). With respect to the test in toluene (Pcx R-18), the resin had "partly agglomerated" but with "eight hard shakes" it became "free-flowing" (RT 418). Mr. Bennahmias testified that the resin R-16 would not remain free flowing in aromatic hydrocarbon solvents (RT 418-419), and that testimony was not contradicted.

Thus, at the time of trial, all solubility tests conducted with resins made during Radiant's inter partes tests on September 2 and 3, 1965, showed, consistently, that the melamine, sulfonamide and aldehyde components of the accused pigment would not produce a resin which would remain free flowing in aromatic hydrocarbon solvents. Both of Radiant's Wayne and Bennahmias inter partes test resins R-7 and R-16 had agglomerated in benzene and there was evidence that they would eventually agglomerate in toluene.

Mr. Bennahmias also testified and demonstrated that the interpartes Wayne and Bennahmias test resins made on September 2 and 3, 1965 behaved in essentially the same manner as another

7-4-1 test resin produced in Radiant's laboratory for use in the original contempt proceedings (Pcx R-43 and R-44; RT 405-410).

Summary

For the foregoing reasons, Radiant submits that the District Court committed error with respect to each of the matters set forth in specifications 1 through 8 both inclusive. The District Court should have permitted Radiant to rely upon experiments performed with the same raw materials, the same batch sizes, and the same time-temperature relationships as it used in producing the accused pigments. It was wholly erroneous, Radiant submits, for the District Court to expect the ordinary chemist to cast about and to perform hypothetical experiments having little or no real relationship with the accused product and process. Radiant submits that Rule 52(a) is not applicable to the subject matter of said errors. This, for the reasons stated in *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.*, (7 Cir. 1952), 196 F.2d 103, 107:

". . . This is so for the reason that we think the issue for decision is legal rather than factual and, furthermore, we are not so much concerned with the findings made by Judge Dewey as we are with those which he failed to make and on one important issue (subsequently discussed) which he refused to make."

The District Court erred in defining aromatic hydrocarbon solvents

In this portion of the argument, Radiant urges that the Court committed error in writing the aromatic hydrocarbon solvent "benzene" out of the claims and looking only to the performance of the test resins in toluene and xylene (Specifications 9 and 10). These errors are directed to the following findings of the District Court:

"... According to the testimony of Dr. Von Fischer, and certain publications introduced at trial (RT 220-225), benzene has a very high solvent power, is the most volatile of the aromatic hydrocarbon solvents, is quite toxic and is not generally employed as a solvent in paint vehicles of the type herein used. Since benzene is the strongest of the three aromatic hydrocarbon solvents, a resin should agglomerate in it first." (CT 113-114).

"... the benzene test conducted by Radiant, showing its JS-738 resin to have agglomerated in benzene after approximately seven weeks, does not disprove that the accused resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (CT 115).

There is no apparent dispute but that resins made with only the three essential ingredients of the patented resin and in the 7-4-1 molar proportions of the accused pigments do *not* remain free flowing in benzene. As a matter of fact, Switzer's house counsel and expert, Mr. Gray, admited under cross examination that some of the 7-4-1 resins Switzer had made and tested in benzene agglomerated within a week (RT 135-137).

Nevertheless, as shown above Switzer persuaded the District Court to reject benzene as a proper medium for testing a resin, since it is a very strong solvent and is not generally used in the manufacture of paints (CT 114). But there is nothing in the patent which distinguishes between one aromatic hydrocarbon solvent and another. The term "aromatic hydrocarbon solvents" as used in the patent specification and claims is a generic, all-inclusive expression; it is not limited to a single aromatic hydrocarbon solvent or to a limited few aromatic hydrocarbon solvents (Dcx S-14, Col. 6, Il. 4-8). Although Switzer's expert on the original trial, Dr. Hatcher, used only toluene in conducting his solubility experiments, he specially corrected himself to state that the patent taught resins which were insoluble in all aromatic hydrocarbon solvents, not just toluene (OR 392):

"Q. (By Mr. Manahan): How does Kazenas teach that no unreacting ingredients are present in its resin?

"A. By teaching that it's insoluble in toluene.

"The Court: I am sorry, I didn't hear your answer.

"The Witness: I say that it is insoluble in toluene.

"The Court: I still didn't get it.

"The Witness: Insoluble in toluene.

"The Court: Insoluble.

"The Witness: Or, rather, I should say in aromatic solvents."

Furthermore, the District Court's first memorandum of decision specifically refers to a prior art patent to Moss-White and

the teaching of a resin consisting "of two compounds both largely insoluble in benzene, which separate independently from a benzene solution" (OR 130-131). The Court distinguished the resin of that patent on several grounds including the fact that it "does not indicate that the described resin is a homogeneous resin, itself, substantially insoluble in aromatic hydrocarbons." (OR 131). Thus, Judge Goodman construed the test of "insolubility" in aromatic hydrocarbon solvents to include benzene.

Benzene is the simplest (parent) of all aromatic hydrocarbon solvents and it is used in the paint industry (Dcx S-38 and S-40; RT 289, 290). Dr. von Fischer on cross-examination conceded that benzene was sometimes used in paint vehicles. He conceded (RT 289), that "I am sure there is a small quantity used in specialty finishes." and that "Benzene is a member of the aromatic hydrocarbon series and, I have said, is used to a limited extent in paint formulations—specialty type formulations."

This Court's decision on the first appeal is stated in such general terms that it does not warrant a reconstruction of the phrase "aromatic hydrocarbon solvents" so as to eliminate benzene from its scope. To the contrary, this Court characterized the Kazenas resin as being one "which remains insoluble without agglomeration in aromatic hydrocarbon solvents" (299 F.2d 162-163). In comparison with the Japanese resin, this Court said the patent resin "differs . . . in that it is soluble in aromatic hydrocarbons, while the Kazenas resin in substantially insoluble" (299 F.2d 163). The earlier opinion of this Court referred to "aromatic solvents", "aromatic hydrocarbon solvents" and "aromatic hydrocarbons", always in the plural, and not to any one solvent in its delineation of the Kazenas patent (299 F.2d 162, 163, 164, 165, 166, 168).

The requirement of the patent that the insolubility of a resin be tested in "aromatic hydrocarbon solvents" demands that the test be met with all aromatic hydrocarbon solvents rather than with one or only some aromatic hydrocarbon solvents. It is a well-established rule of patent law, applied in chemical patent cases, that claims which cover a broad chemical group are permissible only if all members of the chemical group are effective to obtain

the claimed result. Corona Co. v. Dovan Corp. (1928), 276 U.S. 358, 385; and Graver Mfg. Co. v. Linde Co. (1949), 336 U.S. 271, 276-277. Since this Court has already held claims 1, 2, 3, 4 and 9 of the Kazenas patent valid, those claims must now be construed on the contempt hearings in a manner consistent with their validity.

Radiant submits, therefore, that specifications of error 9 and 10 should be sustained. These two errors, like those discussed in the prior section of this brief, relate to matters of law and do not depend upon the credibility of witnesses. Accordingly, a rejection of the Court's findings is warranted upon the authority of *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.* (7 Cir. 1952), 196 F.2d 103, 107, and *United States v. Parke, Davis & Co.* (1960), 362 U.S. 29, 44.

The District Court erred in lapse of time for evaluating insolubility

In evaluating the qualitative tests of insolubility, that is the capability of the test resin to remain suspended without agglomeration or coalescence in the hydrocarbon solvents, the District Court did not require that any of the experimental test resins should remain insoluble in aromatic hydrocarbon solvents but permitted Switzer to rely upon free flowing capabilities for limited, yet indeterminate, periods of time. In this connection, the District Court found specifically:

". . . There is a dispute, however, over how long the resin must remain suspended without coalescence or agglomeration to come within the defining words of the patent claim: 'substantially insoluble in aromatic hydrocarbon solvents.'

"At the original trial in 1959 before Judge Goodman, the Court considered only tests in pure toluene in determining whether the resin was substantially insoluble in an aromatic hydrocarbon solvent. Furthermore, at the original trial, the lapse of time between the date when the resin was placed in toluene and the date when the observations of the condition of the resin in the toluene were made, was less than one week.

"Switzer demonstrated during this contempt hearing that its test resin remained free flowing and dispersed 24 hours after being placed in the pure solvents. Switzer also demonstrated at the trial that the resin placed in the solvents on September 25, 1965, which had stood unshaken for 17 days, free-flowing upon being shaken at the trial." (CT 111-112).

* * * * * * *

"The JS-738 resin, which was placed in benzene on September 3, 1965 (Radiant's Exhibit No. 17) was introduced in evidence by Radiant and appeared to be agglomerated at the time of trial. But the JS-738 resin, which was placed in the toluene on September 3, 1965, (Radiant's Exhibit No. 18) was free-flowing—notwithstanding Mr. Bennahmias' statement that he thought it was partly agglomerated (RT 418). Further, the JS-738 resin, which was placed in xylene on September 3, 1965, (Radiant's Exhibit No. 19) was also free-flowing at the time of trial.

"Radiant relies greatly upon the test which showed that on the date of trial, the JS-738 resin, which had been placed in benzene on September 3, 1965, appeared to be agglom-

erated.

"However, all resins of this type will eventually agglomerate in any pure aromatic hydrocarbon solvent. The stronger the solvent the less time it will take to agglomerate. . . ." (CT 113).

Upon the basis of the foregoing and other determinations, the Court concluded:

"It is, therefore, the finding of the Court that, when taken together, the 24 hour and 17 day qualitative tests conducted by Switzer, and the qualitative tests conducted by Radiant which showed that their JS-738 resin was free flowing and dispersed in toluene and xylene after approximately seven weeks, are simple clear reliable tests, which demonstrate that, in fact, the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (CT 115).

Specifications 11, 12, 13 and 14 assert error in regard to these determinations. Certainly unless an accused resin remains free flowing in aromatic hydrocarbon solvents without agglomeration for a substantial period of time and for at least as long as four months, it does not meet the standard which Switzer itself established at the original trial to sustain validity and the standard upon which this Court held the Kazenas patent valid in the first

instance. The same standard of solubility should have been used on the contempt hearings as that which was used in establishing validity in the first instance.

In the first trial and on the first appeal, Radiant attacked the validity of the Kazenas patent contending, among other things, that the language of the claim was indefinite, particularly since there is no lower critical limit in the amount of melamine compound required to make a resin that was "substantially insoluble in aromatic hydrocarbon solvents".

Radiant's expert on the original trial, Mr. Paulsen, testified, based on solubility tests of one week, to the effect that there was no critical lower limit in the amount of melamine required to produce the functional results specified in the claim. Mr. Paulsen's tests showed that both the patented resin and the resin of the prior art Japanese patent would agglomerate in aromatic hydrocarbon solvents, an increase in the amount of melamine producing only a gradual change in solubility (OR 284-285; 288-289). Moreover, Mr. Paulsen testified that observations made one day after mixing a crushed resin in the solvent would not necessarily be the same after six days, depending on the resin tested (OR 357).

But the testimony of Switzer's expert, Dr. Hatcher, showed that the patented resin was one which "remained free-flowing" and "did not agglomerate" in aromatic hydrocarbon solvents (OR 397, 400-401, 407 and 412). Dr. Hatcher's testimony was based on a test conducted by placing an example of the patented resin in an aromatic hydrocarbon solvent and allowing it to stand for more than four months. Dr. Hatcher testified as to the solubility of that resin as follows:

- "Q. How difficult is the solubility test for a resin?
- "A. It is not difficult. It is readily observable." (OR 397)
 - "Q. What was the solubility of this resin in toluene?
 - "A. It was insoluble in toluene.
 - "Q. How can you tell?
- "A. By dispersing it in toluene and leaving it. It did not agglomerate. It remained free-flowing.

"Q. When was this resin prepared?

"A. It was prepared in late August, 1958.

- "Q. Have you had that sample under your watch and care ever since?
 - "A. I have had it in by possession since that time.

'Q. Is the resin still insoluble?

"A. The resin still is insoluble. It is free-flowing." (OR 400-401)

Under cross-examination, Dr. Hatcher also testified:

"Q. In the Japanese resin, I think that we are in agreement that its not substantially insoluble in aromatic hydrocarbon solvent?

"A. That is correct.

"Q. And it is your position that Example 5 of the Kazenas resin is essentially insoluble in hydrocarbon solvents?

"A. Yes, it is.

"Q. At what point between 5% of the Japanese Patent and 13% of the Kazenas Example 5 does one note a change from insolubility—I mean from solubility to insolubility?

"A. I do not have that information. I know that at 5%

it is soluble, at 13% it is insoluble.

"Q. Have you made any tests to determine what would happen if you would increase the percentage of melamine in the Japanese example by gradual increment to the percentage of melamine in Example 5 of Kazenas?

"A. No, I have not.

- "Q. As a man skilled in the art, if we were to increase the percentage in the Japanese example from 5% to 7%, would there be a decrease in solubility in aromatic hydrocarbon solvents?
- "A. I cannot say definitely; I can only speculate. At some point there would come the point at which the raw material would be free-flow. I do not know at what point that would be between 5 and 13%." (OR 412)

Judge Goodman relied on the testimony of Dr. Hatcher and expressly rejected the testimony of plaintiff's expert as "not convincing":

"Plaintiffs' expert testimony to the effect that the upper and lower limits specified in the patent are not in fact critical was not convincing . . . The experiments performed by Plaintiffs' expert to test the properties of resin samples prepared in accordance with the examples in the Kazenas patent, in the opinion of the Court, are not reliable evidence to support Plaintiffs' contention that as one approaches the lower limit of the critical range within which the melamine content may be varied the proportion of melamine is inadequate to produce the aromatic hydrocarbon insolubility claimed by the patent. . . .'' (OR 135)

Not only did Judge Goodman refuse to accept the testimony of Radiant's expert, but he sustained the opposition of Switzer and refused to consider post-decision tests which demonstrated the absence of a lower critical limit in the amount of melamine required to produce resins that would "remain" free flowing without agglomeration in aromatic hydrocarbon solvents. Following the first trial, but prior to appeal, Radiant brought a motion for a new trial based on newly discovered evidence (OR 211). In particular, Radiant offered testimony relating to post-decision tests and invited the Court to take a second look at physicial evidence which had been offered at trial to demonstrate the free flowing and insoluble character of the Kazenas resin, asserting that such second look would demonstrate that since trial the resins had agglomerated. Switzer opposed this offer of proof and argued that there was no evidence as to the conditions to which this exhibit had been subjected following trial. The District Court sustained Switzer's opposition and refused to consider Radiant's new evidence (OR 251).

On appeal, Switzer's argument to this Court emphasized the importance of Dr. Hatcher's tests and the fact that those tests had been carried out some four months prior to trial:

". . . In further support of his pre-trial affidavit (R. 48), Dr. Hatcher explained to the Trial Court that when he dispersed the Kazenas Example 5 resin in toluene: 'It did not

agglomerate. It remained free-flowing' (R. 400).

"This initial toluene insolubility test for the Kazenas resin of Dx. N had been carried out some four months before the trial (R. 401), yet Dr. Hatcher was able to demonstrate these test results to the Court at the time of trial since the resin was still free-flowing in Dx. N (R. 401)." (Appellee's Brief on first Appeal, p. 9-10)

In view of all of the foregoing circumstances, this Court upon the first appeal concluded that there was real novelty and invention in providing for a thermoplastic melamine sulfonamide aldehyde resin which would remain insoluble in aromatic hydrocarbon solvents without agglomeration. This Court used the word "remains" too pointedly to permit any misunderstanding but that this Court did indeed attach significance to that characteristic of the patented resin (299 F.2d 162-163):

"The Kazenas patent is for a resin which is a co-condensation of all three of these chemical components and which is thermoplastic but still is capable of being finely ground and which remains insoluble without agglomeration in aromatic hydrocarbon solvents."

By its footnote, this Court keyed the foregoing quotation directly to the language of the claims. This defines what this Court meant when it construed the words "substantially insoluble in aromatic hydrocarbon solvents".

There is nothing in the decision of the Court, nor is there anything in the patent specification, which warrants any deviation from the usual meaning of the word "remains".

The word "remains" is defined in Webster's Unabridged Dictionary as: "to continue unchanged in form, condition, status, or quantity." Radiant submits that this definition, which is not limited by time, is in accord with both the testmony of Switzer's first expert, Dr. Hatcher, and the earlier decision of this Court. Even Switzer's new expert, Dr. von Fischer, testified in the contempt trial that a resin which "must remain suspended without agglomeration or coalescence" in order to be "substantially insoluble" would have to stand in a suspended condition for "an infinite period of time" or "forever" (RT 256).

The District Court found, contrary to the fact shown in the original record, that "at the original trial, the lapse of time between the date when the resin was placed in toluene and the date when the observations of the condition of the resin in the toluene were made, was less than one week." (CT 112). This finding, as pointed out in specification of error 12, is clearly erroneous. There is no evidence to support it. To the direct contrary Judge

Goodman expressly rejected as being "not reliable" the only solubility tests based on a one week observation (OR 135).

In view of the recent findings of the District Court that "all resins of this type will eventually agglomerate in any pure aromatic hydrocarbon solvent" (CT 113), it is now apparent that the District Court, and Switzer as well, have disowned Dr. Hatcher's tests and testimony as showing a critical lower limit in the amount of melamine necessary to produce a resin which remains free flowing without agglomeration in aromatic hydrocarbon solvents. Nevertheless, on this contempt charge, Switzer and Radiant alike are now bound by this Court's earlier decision. Radiant contends that the matter of infringement (as far as the contempt proceeding is concerned) is to be governed by the "critical limits" by which Switzer induced this Court to hold the claims valid. It is wholly unreasonable for Switzer to have the claims sustained based on insolubility tests lasting more than four months (and testimony that patented resins "remained freeflowing") and then to assert an infringement based on tests lasting one day and, at the most, seven weeks. Yet this is precisely what Switzer has done.

This Court held that the functional language in the claims did not invalidate the claims but by the same token it served to fix precisely the limits of the claims (348 F.2d 246). This Court further expressly rejected Switzer's contention in the first contempt appeal that, irrespective of the qualitative effect produced by the melamine ingredient, its patent covered M-S-F resins that were equivalent for the same use as patented resins (348 F.2d 246). Radiant respectfully submits that Switzer is now estopped by its earlier representations to this Court from asserting that resins which do not remain free flowing are nevertheless covered by the patent.

The facts of this case are very much the same as those in *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.* (7 Cir. 1952), 196 F.2d 103, cert. den. (1952), 343 U.S. 967, reh. den. (1952), 344 U.S. 849. In that case the Court considered a contempt order entered upon certain chemical welding flux claims which had been held valid and infringed in *Graver Mfg. Co. v.*

Linde Co. (1949), 336 U.S. 271, and Graver Mfg. Co. v. Linde Co. (1950), 339 U.S. 605. The claims based their novelty on the feature that one or more alkaline earth metal silicates were present in "a major proportion." The Court of Appeals reversed a contempt order based upon a flux which contained silicates in amounts less than 50%. Specifically, the Court held that an enlarged interpretation of the proportions feature would leave the validity of the claims "open to serious challenge because of their indefiniteness and uncertainty." (196 F.2d 109). Moreover, the Court held that the patentee was bound by its earlier arguments made to secure the favorable adjudication in the first instance (196 F.2d 111-112). At page 112, the Court concluded:

"In our opinion, the application of the doctrine of equivalency in this case is to ignore the teachings of the patent, the representation upon which the claims in suit were allowed and, more pointedly perhaps, the representations by which their validity has been sustained in the courts. While the difference between plaintiff's composition and those accused may not be great, it is that difference which distinguished plaintiff's composition from the prior art and which enabled it to sustain the validity of its grant. It is now estopped from claiming otherwise.

"The judgment appealed from is reversed and remanded,

with directions that it be vacated."

In the case at bar, this Court sustained the claims of the Kazenas patent on the interpretation that the melamine amount is critical and may be readily determined by "a simple, clear test". Such a test is essential to sustain the claims, and to now ignore that test is to leave their validity again open to serious challenge. Switzer used the testimony of its expert, Dr. Hatcher, to show that the patented resin "remained free-flowing" for some four months before the trial (OR 400-401). Switzer also argued that "the term 'substantially insoluble' defines a transition point that is critical with respect to the pigment use. And it is critical with respect to the distinction between the Kazenas invention and the Japanese patent" (Appellee's Brief on First Appeal, pp. 31-32). It is now too late for Switzer to enlarge the scope of its patent when it is shown that the melamine of the

accused pigment, like the melamine of the prior art Japanese resin, is insufficient to prevent agglomeration in aromatic hydrocarbon solvents. While the difference between resins of the Kazenas patent (which remain free flowing for at least four months) and the patented raw materials, and their proportions, used in the accused pigments (which remain free flowing for less than one week) is only a matter of degree, it was by virtue of such a difference that Switzer sustained the validity of the Kazenas patent. Switzer is now estopped from claiming otherwise.

Finally on this issue, the District Court relied upon certain experiments showing that the resins of the specific examples of the Kazenas patent were free flowing and dispersible in acrylic and alkyd paint vehicles for more than 5 years (CT 114; Dcx S-22 through S-27; RT 102-113). These experiments tend to prove nothing within the issues of this case. In the first place, the examples of the Kazenas patent are not the same as either the accused pigment or the melamine-sulfonamide-aldehyde raw materials and proportions used in the accused pigment. Consequently, the examples are not probative of the behavior of the three resin components of the accused pigment. In the second place, the issue before the Court was concerned with substantial insolubility in aromatic hydrocarbon solvents, not substantial insolubility in acrylic and alkyd paint vehicles. In the third place, these tests indicate the capability of the patented resins to remain free flowing and dispersible for a period of more than 5 years. This is permanent as compared with the very limited free flowing life of the three essential ingredients of the accused pigment in aromatic hydrocarbon solvents. The mere fact that Switzer found it necessary to rely upon such peripheral experiments should, we submit, cast real doubt upon the entire contempt issue.

In summary, Radiant contends that the word "remains" as used in this Court's earlier decision requires that a patented resin be one that is free flowing in aromatic hydrocarbon solvents for no shorter a period of time than that which this Court found necessary to sustain the validity of the claims. Since both the District Court and this Court relied upon the testimony and tests of

Switzer's former expert, Dr. Hatcher, to hold the Kazenas patent valid, the same test period, namely, at least four months, must be used to evaluate Switzer's charge of infringement. Inasmuch as the evidence obtained from Switzer's own expert shows that the 7-4-1 resin portions of the accused 4-C pigments do *not* contain sufficient melamine to prevent agglomeration in benzene when allowed to stand for even one week (RT 135-137), a fortiori, there can be no infringement. The fact that the District Court now finds that "all resins of this type will eventually agglomerate in any pure aromatic hydrocarbon solvent" is immaterial as far as the issue of infringement is concerned. Such a finding merely exposes the cynicism of Switzer in debating Radiant's earlier contention that there is no lower critical limit with respect to the amount of melamine compound required to produce a free flowing resin.

Summation as to specifications 1 through 14

With this argument based upon errors 1 through 14 both inclusive, we pause to urge that they show and illustrate the rationale upon which the Court decided the entire contempt matter. This appears from the Court's discussion which follows the subject matter which we have now covered in this argument:

"The Court, however, in no wise suggests that the above tests represent the minimum standard for determining the question presented or that the 24 hour qualitative test, alone, would not suffice for determining the question here. The Court merely holds that the above tests when considered together do in fact show beyond any doubt that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (CT 115-116).

Specification 14 urges error in the general conclusion thus quoted. That error depends upon error 1 through 13 and, we submit, it should be sustained for the reasons already argued.

Nonetheless, despite the fact that the Court had concluded on the basis of the tests already discussed that Radiant infringed the Kazenas claims, the Court in what is more or less in the nature of an epilogue discusses subsidiary experiments in support of the conclusion thus reached (CT 116-119). We now argue that—

The District Court erred in considering quantitative tests of solubility

The first series of subsidiary experiments upon which the District Court relied to substantiate the earlier findings of infringement are based upon certain 24 hour quantiative solubility experiments which Switzer made upon a number of the test resins which indicated that minute amounts of the test resins went into solution in a 24 hour period when the results were measured quantitatively (CT 116-117). Radiant submits that it was improper for the District Court to give credence to any quantitative tests of solubility and directs specifications 15, 16, 17, 18, 19 and 20 to this portion of the opinion of the District Court.

The Kazenas patent does not define the term "substantially insoluble" in quantitative values (Dcx S-14; RT 14); and neither Radiant's expert nor Switzer's experts could attach a numerical value to the term "substantially insoluble" for purposes of establishing a quantitative test (RT 157-159; 248; 611-612; 629). Query, then, how is one skilled in the art to know if a resin is substantially insoluble?

Switzer's expert, Mr. Gray, testified that a resin which would go into solution only in an amount of .022 grams per hundred milliliters would be substantially insoluble (RT 160-161). But he admitted that he knew of no teaching which tells you when you reach the point where you have something that is soluble and when you get away from the point where you have something substantially insoluble (RT 157); nor was he able to say where that point would be (RT 157). When asked how you would determine "on a quantitative basis when one reaches the point where the resin is no longer substantially insoluble" but "becomes soluble", Mr. Gray answered simply: "The question of solubility is a relative matter and you would have to look to the uses to which you intend to put it, and you would have to conduct experimentation within that area" (RT 158). Even so, Mr. Gray admitted that he had done no work upon which he could base an opinion as to a quantitative number which might be indicative of "quantitative insolubility" (RT 158-159). Mr. Gray's opinion that .022 grams per hundred milliliters is substantially insoluble was simply based on "the size of the figure" (RT 160).

Switzer's other expert, Dr. von Fischer, was no more definite than Mr. Gray in establishing a quantitative value for the term "substantially insoluble". Dr. von Fischer could only suggest that the dictionary definition of insoluble should be applied, namely, "Not dissolving in a solvent (except in minute amounts)." (RT 229; Dcx S-42). Dr. von Fisher admitted that the term "insoluble" is a relative one and not a quantitative expression—"it would allow for a wide variance in the amounts of materials that would dissolve" (RT 230). In the resin field, according to Dr. von Fischer, a minute amount would "depend on the conditions under which the resin is used. It is a practical consideration. . . . The practical consideration would be to use the resin in the application or type of application to which it would be used, or its industrial purpose, to see whether or not it would work satisfactorily, and this could not be related with a number figure." (RT 248). If he were to set a numerical limit on something which will remain insoluble in aromatic hydrocarbon solvents, he would proceed "only by trying the resins practically in a formulation to see whether or not they remain stable . . . in a finished paint or ink". (RT 269-270).

The uncontroverted evidence shows that the prior art Japanese patent has a solubility of only 0.18 grams per hundred milliliters of toluene when tested on a 24-hour basis (Pcx R-48; Dcx S-15; RT 531-532). In his opening statement to the District Court, Switzer's counsel represented that a solubility of "only 0.15 grams" of resin is substantially insoluble (RT 13, 16), and that a solubility "on the order . . . of one tenth of a gram for a hundred milliliters of solvent" is to be considered substantial insolubility (RT 39). Such a test cannot soundly be brought forth at this late day because the Japanese resin is clearly substantially insoluble by the very same quantitative test which Switzer urges as a basis for finding infringement. If the Japanese resin is different than the resins of the Kazenas patent, as this Court has already found, then the quantitative test has no significance in defining the term "substantially insoluble".

There is another reason why 24-hour quantitative tests should not determine the ultimate issue of infringement. Those tests

were premised upon Dr. von Fischer's belief that M-S-F resins attain equilibrium in solutions in less than 24 hours (RT 234-237). He assumed that the saturation point (equilibrium) would be reached in a very short period of time "but certainly, again, within a maximum of a 24-hour period" (RT 236).

The record makes clear that Dr. von Fischer was dead wrong in this assumption. The only tests conducted by the parties and made of record in the contempt proceedings demonstrate that equilibrium is *not* reached in 24 hours (RT 536-556; Pcx R-49 through R-56). Using the same procedure as that used by Dr. von Fischer for taking Switzer's solubility readings, Radiant's expert, Dr. Weiner, found that the Wayne test resin did not reach equilibrium in the aromatic hydrocarbon solvent benzene for more than 33 days (Pcx R-56). When the Wayne resin was tested by stirring the resin in benzene (a method not used by Switzer but which hastens equilibrium), equilibrium did not occur in 46 hours (Pcx R-54). There is no evidence in this case contradicting these facts.

Dr. von Fischer did not conduct any test to determine whether equilibrium was actually reached in a period of 24 hours (RT 246). The only quantitative tests conducted by Dr. von Fischer were for a maximum of 24 hours and at no time did he make a determination as to whether equilibrium is reached in 24 hours (RT 247).

Radiant submits therefore that the evidence as a whole shows that Switzer's "24 hour quantitative test" cannot be relied upon either to determine which resins will remain insoluble or to define the meaning of "substantially insoluble in aromatic hydrocarbon solvents" by reference to some numerical figure. They are not pertinent to this Court's earlier decision that the Kazenas resin "remains insoluble without agglomeration in aromatic hydrocarbon solvents" (299 F.2d 162-163). Specifications 15 through 20 should be sustained.

The fundamental difficulty with the 24 hour quantitative tests is that experiments in that area do not serve to distinguish the critical limit between the Japanese prior art resin and the patented resin. When the Japanese patent has a solubility of only 0.18

grams per 100 millileters toluene when tested on a 24 hour basis, the Japanese patent undebatedly meets the definition of the Kazenas claims that the amount of melamine is an amount sufficient to render the resin substantially insoluble in aromatic hydrocarbon solvents. Remembering that the words "substantially insoluble" are relative terms and remembering that the pure sulfonamide aldehyde resin (Santolite MHP) has a solubility of more than 300 grams per 100 milliliters of toluene (RT 557) the quantitative tests can be justified only to make out a case of patent invalidity. The reason for this is that anything which would infringe a patent if later, anticipates it if earlier. Knapp v. Morss (1893), 150 U.S.221, 228. On the merits of the contempt issue, Radiant has accepted the proposition that it cannot attack the validity of the underlying claims. By the same token, Switzer should not be permitted to read into the claims any experiments which would render them invalid. Radiant submits that the District Court committed clear error in relying upon any of the quantitative tests in the specifics set forth in specifications 15 through 20, both inclusive.

The District Court also erred in its evaluation of the urea containing test resins

The District Court recognized that the question whether the urea of the accused pigments produces or tends to produce substantial insolubility in aromatic hydrocarbon solvents is *not* the determinative issue (CT 117). Nevertheless, the Court held "that the additional urea, itself, has little or no effect in producing such substantial insolubility" (CT 117). The evidence referred to in the Court's opinion was then used "to confirm the Court's finding that it is the melamine, alone, which renders the accused 4-C resin substantially insoluble in the aromatic hydrocarbon solvents" (CT 118). Radiant contends that the latter two findings are erroneous, particularly since the only meaningful evidence in the case shows conclusively that the urea used in the manufacture of the accused pigments contributes substantially to the insolubility of the resin (Specifications 21 and 22).

The Court based the contested findings on certain inter partes test resins (IS-738 and IS-739) and tests made in Radiant's laboratory on September 3, 1965 (CT 118-119). The JS-738 designation represents a 7-4-1 resin, also identified as resin R-16, which was made with the three essential ingredients only of the Kazenas patent; the designation IS-739, also identified as resin S-37, represents a 7-4-1 resin made with the three essential ingredients plus a half mole of urea (RT 210). At the time of trial, Radiant showed that the JS-738 resin had agglomerated in benzene after seven weeks (Pcx R-17; RT 417). Inasmuch as this evidence conclusively showed that 7-4-1 resins would not remain free flowing in aromatic hydrocarbon solvents (and the Court so found) it thus became completely unnecessary and irrelevant for Radiant to show the effect of urea in making the accused pigments. Therefore. Radiant did not introduce in evidence any of the tests made with the IS-739 resin.

The single piece of evidence that the Court relied upon for its finding "that the addition of urea had no apparent effect on the 4-C resin" was that, at the time of trial, Switzer introduced tests of the JS-739 resin (with urea) showing that the resin had agglomerated in benzene (Dcx S-46). Although this evidence shows that the 7-4-1 resin with urea, as well as 7-4-1 resins without urea, agglomerate in benzene within seven weeks, it does *not* demonstrate that the urea had no effect on the solubility of 7-4-1 resins.

Parenthetically, it is anomalous that the Court should reject tests of agglomeration in benzene to show the "substantial insolubility" of the patented resin but yet use benzene tests as a basis for evaluating the comparative solubilities of the JS-738 and 739 resins.

In connection with the earlier contempt proceedings Radiant made tests with resins JS-738 and JS-739. On July 13, 1963, Radiant placed samples of both types of resins in benzene and toluene. At the time of the contempt trial, both resins had agglomerated in benzene (Dcx R-43 and R-46; RT 406, 513), but only the JS-738 resin (made without urea) had agglomerated in toluene (Dcx R-44; RT 516); the JS-739 resin in toluene remained free

flowing (Dcx R-47; RT 516). This evidence clearly shows that the urea qualitatively improved the free flowing character of 7-4-1 resins.

Switzer's own testing of the JS-738 and JS-739 resins shows that the resin made without urea (JS-738) is more soluble on a quantitative basis than the JS-739. This evidence was adopted by the District Court under its discussion of Switzer's "24 hour quantitative test" (CT 116). According to Switzer, the JS-738 resin has a solubility of 0.020 grams per hundred milliliters of benzene while the JS-739 resin has a solubility of 0.010 grams per hundred milliliters. A second test conducted by Switzer showed that 0.007 grams of the JS-738 resin would dissolve per hundred milliliters of toluene, compared with only 0.002 grams of the JS-739 resin. Thus, Switzer's own figures show that on a quantitative basis, 7-4-1 resins formed without a half mole of urea are twice as soluble in benzene as those containing urea, and more than three times as soluble in toluene.

The accused 4-C pigments, as previously indicated, are made in the molar proportions 7-4-1 with respect to the essential three ingredients of the Kazenas patent. In addition, the accused pigments are made with oxalic acid, a dyestuff and one-half mole of urea (RT 342-343; Pcx R-1). Although both the JS-738 and JS-739 resins agglomerated in benzene in seven weeks (and therefore do not qualify as resins which are substantially insoluble in aromatic hydrocarbon solvents), neither of those resins is the same as the accused pigments. Both resins lack the oxalic acid and the dyestuff of the accused pigment. Those differences account for the fact that neither the JS-738 resin nor the JS-739 resin are as free flowing in aromatic hydrocarbon solvents as the accused pigments.

In the contempt trial, Radiant proved that the accused pigments would remain free flowing in *both* benzene and toluene for more than two years (Pcx R-38 and R-39). Pcx R-38 is a test tube containing the 4-C pigment in benzene (RT 374). The 4-C pigment was placed in the benzene on July 2, 1963 and yet at the time of trial it could be made free flowing by shaking (RT 375). Another exhibit, Pcx R-39, proved that the same resin had remained in-

soluble and free flowing in toluene (RT 376-377). This is a clear demonstration of what this Court meant when it said that a patented resin was one which "remains insoluble in aromatic hydrocarbon solvents". The only difference between the accused pigment and the patented Kazenas resin is that the accused pigment is made free flowing by something other than the melamine alone.

But this difference is one which Switzer in its brief on the first appeal brought forward to sustain the validity of the claims when it recognized, page 50:

". . . If any means other than a sufficient amount of the melamine component were used to render the resin insoluble in aromatic hydrocarbons, the claim would not cover the resulting resin."

Importantly, Radiant does *not* contend that the JS-739 resin could be used as a substitute for Radiant's 4-C resin. Mr. Bennahmias, one of Radiant's experts, clearly stated that neither the JS-738 nor the JS-739 resin could be used as a substitute for the 4-C resin (RT 505, 473). Radiant does contend that the half mole of urea and other raw materials used to make the accused pigment contribute materially to the ability of the pigment to remain free flowing for a long period of time. The evidence clearly supports Radiant's contention and refutes a finding to the contrary.

Specifications of error numbers 21 and 22 should be sustained.

Summary on contempt issues

The remaining specifications of error, namely specifications 23 through 25, are conclusionary specifications directed to the ultimate issue as to whether the amount of melamine in the accused pigment is sufficient to render the product substantially insoluble in aromatic hydrocarbon solvents. These specifications, therefore, turn upon the results of the argument on underlying specifications 1 through 22, both inclusive. Radiant submits that when the evidence is viewed as a whole, the facts themselves are not in substantial dispute. There is little doubt that each of the chemists conducted the experiments as to which he testified in the manner

set forth in his testimony. The true dispute is a legal dispute as to which experiments, how many experiments, and what kind of experiments are necessary to fulfill the simple clear test requirement which Switzer represented was available at the time of the original hearing on the first appeal. On this legal issue, Switzer should have been bound by the representations which it made to this Court on the first appeal and Radiant should have been permitted to rely upon simple experiments utilizing the same raw ingredients, the same proportions and the same time-temperature relationships as those which it used in making the accused pigment. Any other test or experiment would leave the claims far too indefinite and uncertain to meet the requirements of U.S. Code, Title 35. Section 112.

To these specifications, the views expressed in *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.* (7 Cir. 1952), 196 F.2d 103, at page 109, are most germane:

"We suspect, however, that plaintiff's failure previously to advance its present definition of 'a major proportion' was due to the realization that such a concession would place in serious question the validity of the claims. If 'a major proportion' means or can be interpreted to mean any percent— 10, 20 or 40—their validity would be open to serious challenge because of their indefiniteness and uncertainty. As the Supreme Court said, first decision, 336 U.S. at page 277, 69 S.Ct. at page 538, 'The statute makes provision for specification separately from the claims and requires that the latter "shall particularly point out and distinctly claim the part, improvement, or combination which he claims as his invention or discovery." (Title 35 U.S.C.A. § 33.) These observations, of course, are not intended to reflect upon the validity of the claims, but they are such that we should hesitate to now accede to an interpretation which, if it had been made at the time their validity was under attack, would in all probability have resulted in a contrary decision on that issue."

THE CONTEMPT ORDER SHOULD BE REVERSED BECAUSE THE SUPPORTING EVIDENCE PROVES THAT THE KAZENAS PATENT VIOLATES 35 U.S.C. 112

We have shown above, in answer to the first question posed on this appeal, that the contempt order should be reversed—on

its own merits—because it is clearly erroneous in light of the record and prior opinions of this Court. We now turn to the second question which asks this Court, independently of its decision on the first question, to now redetermine whether the Kazenas patent violates U. S. Code, Title 35, Section 112. This second question is presented on the new circumstances which Switzer opened up on the contempt hearing, and the case law applicable to those circumstances.

That portion of Section 112 which is appropriate to this second question reads:

"The specification shall conclude with one or more claims particularly pointing out and distinctly claiming the subject matter which the applicant regards as his invention."

The burden which Radiant assumes on the merits of this second question is that the new circumstances and the case law applicable to those circumstances demonstrate that the claims do not particularly point out and distinctly claim any invention.

In posing this second question, Radiant concedes, as it must, the general proposition that the doctrine of "the law of the case" is normally binding on this Court upon this review. This Court has applied the general proposition, in patent and non-patent cases alike, in opinions too comprehensive in scope to leave any doubt that the doctrine of the law of the case upon a second appeal is one with strong and deep roots. There is, however, another group of cases in which this Court has rejected the law of the case in order to conclude upon a subsequent appeal that its earlier decision was erroneous. There is a third group of cases in which this Court has noted its power to re-examine its

^{1.} Clinton v. Joshua Hendy Corporation (9 Cir. 1960), 285 F.2d 199, 200, cert. den. (1961), 366 U.S. 932; Citizens Nat. T. & S. Bank of Los Angeles v. United States (9 Cir. 1959), 270 F.2d 128, 132; and Coleman Company v. Holly Manufacturing Company (9 Cir. 1959), 269 F.2d 660, 664.

^{2.} Helms Bakeries v. C.I.R. (9 Cir. 1959), 263 F.2d 642, 644, cert. den. (1959), 360 U.S. 903, reh. den. (1959), 361 U.S. 857; United States v. Fullard-Leo (9 Cir. 1946), 156 F.2d 756, 757, aff'd. (1947), 331 U.S. 256; and Electrical Research Products v. Gross (9 Cir. 1941), 120 F.2d 301, 307, reh. den. (1942), 125 F.2d 912.

earlier decision, but has reached the same conclusion on the second appeal as that which it had reached on the first appeal.³

The second question, therefore, of necessity first addresses itself to the power of this Court to reconsider its earlier decision on the first appeal and to reach a contrary conclusion on this appeal. We here show that many recent cases reflect an accelerating trend to qualify and depart from strict application of the rule of the law of the case. This trend, pinpointed in *Union Light*. H. & P. Co. v. Blackwell's Adm'r. (Ky. 1956), 291 S. W. 2d 539, 543, 87 A. L. R. 2d 264, 269, is evidenced in a fairly complete annotation "Erroneous decision as law of the case on subsequent appellate review", 87 A. L. R. 2d 271-360. That note points out:

". . . The conflict in the authorities is a reflection of the existing conflict of two important principles governing the courts in the administration of justice. The first of these principles is that an erroneous judgment should not stand. The other is that at some time there must be an end to litigation and a final decision that parties can rely on. The ultimate test is which of these two principles is regarded more important for the administration of justice." (87 ALR 2d 278, footnotes omitted).

"The view relaxing the doctrine of the law of the case has been rested on the ground that an appellate court's duty to administer justice under the law outweighs its duly to be consistent." (87 ALR 2d 284, footnote omitted)

Mr. Justice Frankfurter, dissenting because the Court granted certiorari to affirm a Court of Appeals decision, had this to say in Lawlor v. National Screen Service (1957), 352 U.S. 992, 994:

"... In the federal courts 'the law of the case' is not a legal principle. It is a bogey that has been exposed, a ghost that has been laid, since Mr. Justice Holmes' opinion for the Court in Messinger v. Anderson, 225 U.S. 436, 444. The misuse of the rule of practice embodied in the conception of

^{3.} Cervantes v. United States (9 Cir. 1960), 278 F.2d 350, 352; Woodworkers Tool Works v. Byrne (9 Cir. 1953), 202 F.2d 530; City of Seattle v. Puget Sound Power & Light Co. (9 Cir. 1926), 15 F.2d 794, 795, cert. den. (1927), 273 U.S. 752, 753; and Pacific American Fisheries v. Hoof (9 Cir. 1923), 291 Fed. 306, 309, cert. den. (1923), 263 U.S. 712.

'law of the case,' we had occasion to reject in *United States* v. United States Smelting Refining & Mining Co., 339 U.S. 186, 198: 'It is not applicable here because when the case was first remanded, nothing was finally decided. The whole proceeding thereafter was in fieri.'...'

Mr. Justice Holmes' opinion for the Court in Messenger v. Anderson (1912), 225 U.S. 436, stated quite tersely, page 444:

"... In the absence of statute the phrase, law of the case, as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided, not a limit to their power. . . ."

United States v. U. S. Smelting Co. (1950), 339 U.S. 186, quoted above in Lawlor, concludes, page 199:

"... We think that it requires a final judgment to sustain the application of the rule of the law of the case just as it does for the kindred rule of res judicata. Compare United States v. Wallace Co., 336 U.S. 793, 800-801. And although the latter is a uniform rule, the 'law of the case' is only a discretionary rule of practice. It is not controlling here. See Southern R. Co. v. Clift, 260 U.S. 316, 319."

This Court's most recent departure from the general rule located by counsel is *Helms Bakeries v. C.I.R.* (9 Cir. 1959), 263 F.2d 642, cert. den. (1959), 360 U.S. 903, reh. den. (1959), 361 U.S. 857. In that case, this Court overruled an interpretation which it had placed upon the internal revenue code on the first appeal. At page 644, Judge Jertberg, speaking for this Court said:

"We have carefully reexamined the record in this case, and have reviewed our decision on the first appeal in the light of decisions cited by counsel before and after the submission of this cause. We have reached the conclusion that we were in error in assuming jurisdiction on the first appeal in respect to petitioner's claim for relief under section 772(b)(4). The 'law of the case' rule does not preclude us from overruling our prior decision on being convinced that our prior holding was erroneous. White v. Higgins, 1 Cir., 116 F.2d 312, and cases cited therein..."

The next preceding decision located by counsel which relaxes the law of the case is *United States v. Fullard-Leo* (9 Cir. 1946),

156 F.2d 756, affirmed (1947), 331 U.S. 256. There, this Court en banc reconsidered its earlier opinion on the first appeal because of the novelty and importance of some of the questions presented and the division of opinion among the judges on the first appeal. Judge Healy, speaking for the entire bench, Judges Denman and Bone dissenting, said, page 757:

"Notwithstanding our decision on the former appeal we have authority, if we choose to exercise it, to re-examine the several aspects of the case. 'In the absence of statute the phrase, "law of the case," as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided, not a limit to their power.' Messinger v. Anderson, 225 U.S. 436, 444, 32 S.Ct. 739, 740, 56 L.Ed. 1152. Cf., also, Cochran v. M & M Transp. Co., 1 Cir., 110 F.2d 519, 521; Electrical Research Products v. Gross, 9 Cir., 120 F.2d 301, 308. While the power to re-examine questions previously determined should be sparingly exercised, there are occasions when justice requires that course. We think this is one of those occasions. The view of the case expressed in the minority opinion on the former appeal appears to the court as presently constituted to be the just view and it is thought that it should prevail."

In *Electrical Research Products v. Gross* (9 Cir. 1941), 120 F.2d 301, reh. den. (1942), 125 F.2d 912, this Court reconsidered its pronouncements on the first appeal and continued, page 307:

". . . These pronouncements are said to be the law of the case. But the record on the former appeal did not contain appellant's books of account; nor does the opinion contain any discussion of the subject of duress, except insofar as it formed the basis of appellee's counterclaims. Under these circumstances the former decision is not controlling."

In other jurisdictions deciding like the second group of cases in this Circuit, the law of the case has been relaxed where the circumstances on the second appeal indicate clear error in the decision reached on the first appeal. In one line of cases, the prior decision was overruled because of intervening decisions of controlling federal or state courts.⁴ In another line of cases, courts overruled their prior decision because the record on the second appeal presented substantially different circumstances from those stated on the first appeal.⁵ In still another line of cases, the decision on the prior appeal was overruled apparently simply to reexamine questions which were overlooked or incorrectly decided on the first appeal.⁶

The Supreme Court in the case at bar did deny certiorari on the first appeal, but it appears from the cases that this is not a controlling factor. In many of the cases, the courts have overruled their prior opinion notwithstanding the denial of the writ of certiorari on the first appeal.⁷

With this foreword, we turn to the considerations which we urge should persuade this Court to undertake a reconsideration of the question as to whether the Kazenas patent violates U. S. Code, Title 35, Section 112.

The prior appeal decision is interlocutory

An important element enabling relaxation of the law of the case is that the prior appeal was interlocutory. The judgment

^{4.} Page v. St. Louis Southwestern Railway Co. (5 Cir. 1965), 349 F.2d 820, 821; Maryland Casualty Company v. Hallatt (5 Cir. 1964), 326 F.2d 275, 276-277; Connor v. New York Times Company (5 Cir. 1962), 310 F.2d 133, 135; Higgins v. California Prune & Apricot Grower (2 Cir. 1924), 3 F.2d 896, 898; Luminous Unit Co. v. Freeman-Sweet Co. (7 Cir. 1924), 3 F.2d 577, 579-580; and Johnson v. Cadillac Motor Car Co. (2 Cir. 1919), 261 Fed. 878.

^{5.} Chicago, Rock Island & P. R. Co. v. Hugh Breeding, Inc. (10 Cir. 1957), 247 F.2d 217, 223; City of Sedalia v. Shell Petroleum Corporation (8 Cir. 1936), 81 F.2d 193, 196; and Rogers v. Chicago, R.I. & P. Ry. Co. (8 Cir. 1930), 39 F.2d 601, 604.

^{6.} In re Inland Gas Corp. (6 Cir. 1951), 187 F.2d 813; Commercial Nat. Bank in Shreveport v. Connolly (5 Cir. 1949), 176 F.2d 1004; Connett v. City of Jerseyville (7 Cir. 1940), 110 F.2d 1015; and Seagraves v. Wallace (5 Cir. 1934), 69 F.2d 163, 164-165.

^{7.} Maryland Casualty Company v. Hallatt (5 Cir. 1964), 326 F.2d 275, cert. den. (1962), 369 U.S. 819; In re Inland Gas Corp. (6 Cir. 1951), 187 F.2d 813, cert. den. (1946), 329 U.S. 737; City of Sedalia v. Shell Petroleum Corporation (8 Cir. 1936), 81 F.2d 193, cert. den. (1933), 290 U.S. 706; Seagraves v. Wallace (5 Cir. 1934), 69 F.2d 163, cert. den. (1930), 282 U.S. 871; and Luminous Unit Co. v. Freeman-Sweet Co. (7 Cir. 1924), 3 F.2d 577, cert. den. (1919), 253 U.S. 486.

under review on that appeal held the Kazenas patent valid and infringed and retained jurisdiction of the cause so that it could "hereafter set this matter down for hearing as to the amount of damages." (OR 210). The cause was referred to Joseph P. Karesh on February 15, 1960 for an accounting of damages (CT 140); was reassigned to Donald B. Constine on April 2, 1962 (CT 143); and was reassigned to Richard S. Goldsmith on October 20, 1964 (CT 149). The accounting is still pending and no final judgment has been rendered in the court below (CT 149-154). The decision on the contempt proceedings is based upon an injunction granted pursuant to that interlocutory judgment.

There can be little doubt, we submit, that the judgment of validity and infringement thus entered is interlocutory and subject to the continuing control of this Court until the entry of final judgment. This conclusion follows from *Marconi Wireless Co. v. U. S.* (1943), 320 U. S. 1, 47-48; and *Simmons Co. v. Grier Bros. Co.* (1922), 258 U. S. 82, 90-91. In *Marconi Wireless*, the court specifically held, page 47, that an interlocutory decision of the trial court on the question of validity and infringement "was not final until the conclusion of the accounting." Upon such an understanding, the court concluded:

"... Hence the court did not lack power at any time prior to entry of its final judgment at the close of the accounting to reconsider any portion of its decision and reopen any part of the case. Perkins v. Fourniquet, 6 How. 206, 208; McGourkey v. Toledo & Ohio Central Ry. Co., 146 U. S. 536, 544; Simmons Co. v. Grier Bros. Co., supra, 90-91. It was free in its discretion to grant a reargument based either on all the evidence then of record or only the evidence before the court when it rendered its interlocutory decision, or to reopen the case for further evidence."

In Simmons Co. v. Grier Bros. Co. (1922), 258 U. S. 82, the court said, page 89:

"The decree of July 24, 1914, although following a 'final hearing', was not a final decree. It granted to plantiffs a permanent injunction upon both grounds, but an accounting was necessary to bring the suit to a conclusion upon the

merits. An appeal taken to the Circuit Court of Appeals, whose jurisdiction, under § 129 Judicial Code, extended to the revision of interlocutory decrees granting injunctions, followed by the decision of that court reversing in part and affirming in part, did not result in a decree more final than the one reviewed. . . ."

At page 88, the court pointed out that a bill of review follows of final decree and continues:

". . . If it be only interlocutory, the court at any time before final decree may modify or rescind it. . . ."

The interlocutory character of the judgment under review brings into play the rule "that it requires a final judgment to sustain the application of the rule of the law of the case. . . ." [United States v. U. S. Smelting Co. (1950), 339 U. S. 186, 199].

Or, as said in Connor v. New York Times Company (5 Cir. 1962), 310 F.2d 133, 135:

"The previous decision of this Court on interlocutory appeal is not binding either as the law of the case or as res judicata, both because it was not a final judgment and because there has been an intervening decision of the Supreme Court of Alabama creating an altered situation. (citations omitted.)"

The application of U. S. Code, Title 35, Section 112 was not fully covered in the first opinion

Another factor which warrants relaxation of the law of the case doctrine is that this Court in its earlier opinion did not discuss one aspect of the statutory defense, i.e., that the claims are indefinite in the area of the alleged novelty. Specification of error 32 in Appellants' Opening Brief on the first appeal (p. 40) urged error in that the claims did not comply with the statute. In the supporting argument, it was urged that the violation was based "on two separate bases: the first, that the claims are functional at the exact point of novelty; and the second, that they are indefinite." (p. 79). The first basis was argued at pages 79-190 of Appellants' Opening Brief and this Court directed its opinion to that basis. The second point urging that they are indefinite was argued at pages 90-95 of Appellants' Opening

Brief, but it was not mentioned in the opinion of this Court nor were any of the decisions touching upon that issue discussed in the prior opinion. As a consequence, we submit, the inherent rejection of appellants' argument on the prior opinion is not the law of the case on this second appeal.

The rule which Radiant asks this Court thus to follow was applied in *Hartford Life Ins. Co. v. Blincoe* (1921), 255 U. S. 129, at page 136:

"Counsel, however, admit that the question of the inclusion of the tax was not discussed, but insist that 'the question was in the record, was necessarily involved, and was presented,' and invoke the presumption that whatever was within the issue was decided. In other words, that the case was conclusive not only of all that was decided, but

of all that might have been decided.

"From our statement of the issues it is manifest that the quotation from the opinion has other explanation than counsel's, and we need not dwell upon the presumption invoked or the extent of its application in a proper case. The question of the effect of a judgment as a bar or estoppel against the prosecution of a second action upon the same claim or demand, or its effect upon a particular issue or question in some other case, is not here involved. The most that can be said of any question that was decided is, that it became the law of the case and as such binding on the Supreme Court of the State, and to what extent binding is explained in Messenger v. Anderson, 225 U.S. 436. Certainly, omissions do not constitute a part of a decision and become the law of the case, nor does a contention of counsel not responded to. The element of taxes in the assessment was not considered by the Supreme Court, and in this court the Connecticut judgment and its effect were the prominent and determining factors. The question of the inclusion of the tax was not discussed or even referred to. . . ."

In the case at bar, likewise, the predominant and determining factor which this Court discussed in considering the statutory defense was whether the claims were functional at the precise point of novelty. The element of indefiniteness of the indeterminate language of the claims was not discussed or even mentioned in the prior opinion.

One distinction which can be made in the Hartford case is that there the first appeal decision was a reversal, whereas in the case at bar the first decision was an affirmance. This factor does not truly warrant a departure from Hartford. This is shown in Reynolds Spring Co. v. L. A. Young Industries (6 Cir. 1939), 101 F.2d 257. That appeal from a final judgment in a patent infringement accounting followed the affirmance of the interlocutory judgment in Reynolds Spring Co. v. L. A. Young Industries (6 Cir. 1929), 36 F.2d 150. On the first appeal, defendant raised the defense of license and this defense was rejected without discussion in the opinion on the first appeal. The defendant again raised the same defense on the second appeal. On the second appeal, the court considered the defense on the merits on the second appeal, albeit the decision on the merits was adverse. In concluding that it should give the defense full consideration on the second appeal, the court said (101 F.2d 259):

"Appellant insists that it was an implied licensee insofar as it sold any devices embodying appellee's invention to the Ford and Chevrolet Companies. Appellee urges two procedural objections to this question being considered on this appeal, the first of which is that on the former trial in the district court it found that appellant was not an implied licensee and that error was assigned to that ruling on the former appeal to this court, and thus the law of the case was established.

"An examination of the record shows that error was assigned to the ruling of the district court, but the opinion of this court shows that it was not considered on appeal.

"It is a well-recognized rule that an appellate court on a second appeal may review and revise a conclusion reached on the first appeal, it becoming the law of the case only as to the lower court...."

There has been a significant change in facts and circumstances warranting a review of the earlier decision

One of the factors which has persuaded courts to reconsider their own decisions on prior appeal has been a change in facts and circumstances intervening the decision on the first appeal and the hearing on the second. In City of Sedalia v. Shell Petro-

leum Corporation (8 Cir. 1936), 81 F. 2d 193, the court said, page 196:

". . . It is well settled that the decision of an appellate court is ordinarily the law of that case on the points presented, binding in all subsequent proceedings on the lower court. If, however, the evidence is substantially different in material respects from that presented on the former appeal, the rule of the law of the case is not applicable.

And this Court, likewise, in *Electrical Research Products v. Gross* (9 Cir. 1941), 120 F.2d 301, reh. den. (1942), 125 F.2d 912, disregarded the law of the case in part because "the record on the former appeal did not contain appellant's books of account..." (120 F.2d 307).

The new circumstances in this case are not brought about by Radiant in an effort to overturn the first decision. To the direct contrary, the evidence to which reference will be made in this section of the brief refers only to circumstances which Switzer interjected into this case in order to prove up a case of infringement on the contempt matter. In other words, Switzer took the position that these claims were most elastic and Switzer evoked the evidence which now proves that the Court committed error in reaching its original understanding that the claims had distinct and particular meaning.

Switzer has now proved that there is no critical point which remains the same for each melamine compound.

In rejecting Radiant's defense that the limits of melamine are expressed in functional language, this Court distinguished *Gen. Electric Co. v. Wabash Co.* (1938), 304 U. S. 364, in part upon the following representations of Switzer (299 F.2d 165-166):

"In our case Switzer, in justification of the functional language, points out that the alternative would have been to state the critical lower limits precisely. This was done in the examples set forth in the specification. Switzer points to the fact that of the considerable number of melamine compounds encompassed by the patent, each has a different critical limit. It asserts that this renders it wholly unreason-

able to expect the claims to be specific in this respect or to expect any further specificity than that which appears

in the examples given.

"In the General Electric case, the effect of the functional language was to broaden the claim to include *all* grains of whatever size or shape so long as they would accomplish the desired result. In our case the critical area is not enlarged in such a fashion. The critical point remains the same for each melamine compound used. It simply is not specified. But whether specified or unspecified the scope of the claim is precisely that of the invention." (emphasis added).

In the contempt hearings, Switzer proved that the italicized representations simply were not true.

Thomas J. Gray was the first witness on behalf of Switzer (RT 46). He is house counsel for Switzer. In addition to his law degree, Mr. Gray has a Master of Science degree in chemistry from Western Reserve University (RT 49). He became experienced in research and development work in the Switzer laboratory and did chemical experimental work in the laboratory in connection with legal and patent matters in which Switzer was involved (RT 50). He made the experimental test resins which Dr. Hatcher explained at the original trial (OR 462).

On September 25, 1965, Mr. Gray performed an inter partes experiment using the molecular proportions of melamine, formal-dehyde and sulfonamide in the same ratio as the accused resin used melamine, sulfonamide and formaldehyde (RT 123). The purpose was to see if the resin could be made in 7-4-1 proportions and then be tested as to its solubility in aromatic hydrocarbon solvents (RT 128). On cross-examination, he was asked if this was the first test which he had made on such a three component resin (RT 136):

"Q. Now, how many tests are you aware of which Switzer Brothers, Inc., had made with these proportions of 7-4-1 that we have been speaking of, from the time of the first test that you know somebody made in your plant up until the time that you made your test on September 25, 1965?

"A. Well, may I explain one matter, Mr. Hoppe? The

purpose of my tests was not to determine if I could put together a 7-4-1 resin because I was confident that I could do this. The purpose of my tests were to determine if I could put together this resin within time and temperature limitations which I was imposing, and as a result I would say that there probably were maybe a dozen or a dozen and a half tests until I was satisfied that I had met the time and temperature limitations.

"Q. Now, on any of these tests that you made prior to September 25, 1965, did you test any of the powdered resin that was made in those tests for qualitative insolubility

in aromatic hydrocarbon solvents?

"A. Yes.

"Q. On how many occasions did you do that?

"A. Maybe a half dozen of them."

He was also asked the following questions and gave the following answers (RT 137):

"Q. Now, with respect to any of your tests prior to September 25, 1965, did you observe that any of those test resins were such that the resin did in time agglomerate in Benzene?

"A. I think some of them did, some did not.

"Q. Some of them did and some didn't? What is the shortest period of time that some agglomerated in Benzene?

"A. If my recollection serves me right, the shortest time

we tested, or the time we tested, was one week.

"Q. And within one week on some of these 7-4-1 tests that you made you found agglomeration within a week?

"A. That's right.

"Q. On the tests where you found agglomeration within a week did you use the same kind of toluenesulfonamide, the same kind and brand of paraformaldehyde, and the same kind and brand of melamine which you used in the test which you made on September 25th?

"A. Yes, I believe so."

We submit that when one can use the same three identical ingredients and proportions and reach such diverse results that some will agglomerate earlier than others, that the first representation that the critical limit remains the same is unfounded.

Further, in connection with the solubility tests, Mr. Gray was asked the following questions on cross-examination and gave the following answers (RT 163-164):

"Q. Now, when this contempt citation was filed against, or the contempt petition was filed against Radiant Color Company in this case did you have any consideration of what the words in the opinion of the Court of Appeals on the first appeal meant when the Court of Appeals said: The Kazenas patent is for a resin which is a co-condensation of all three of these chemical components and which is thermoplastic but still is capable of being finely ground and which remains insoluble without agglomeration in aromatic hydrocarbon solvents.

Have you given any consideration to those words before the contempt citation was filed here?

"A. I don't recall, Mr. Hoppe.

"Q. To a person who is a chemist in the paint field what is the usual meaning that you would attach to the word 'remains'?

"A. Over some period of time it isn't soluble.

"Q. Is it more than a day?

"A. It may or may not be, depends upon your tests.

"Q. Is it more than a week?

"A. It can be.

"Q. Is a paint in which the pigment is insoluble without agglomeration in aromatic hydrocarbon solvents in which the stuff will be agglomerated within a day, is that a salable paint?

"A. No.

"Q. Is it salable if it will remain suspended for one week?

"A. Probably not. It depends on your use and your customer."

Again, Radiant submits that any test which "depends on your use and your customer" is not one which can possibly remain the same for each different melamine component.

Switzer's second witness on the contempt proceedings was Dr. William von Fischer (RT 192). He is vice president of Switzer and has been in research and development work since at least as early as 1956 (RT 192-193). He has a Bachelor of

Chemistry degree, a Master of Science degree and a Doctor of Philosophy, all in the field of chemistry (RT 193). With respect to solubility, Dr. von Fischer testified on direct examination (RT 228-230):

"Mr. Sherman: Q. Dr. von Fischer, we have had a good deal of discussion about the meaning of certain words, soluble and insoluble. Will you give me your definition of those words?

"A. Well, my definition would be in line with those

given in the Van Nostrand Chemist's Dictionary.

"Q. I shall hand up to you, then, Defendant's Exhibit S-42, a copy of the frontal page and two pages of Van

Nostrand's chemist's dictionary.

"A. This is from a volume that was copyrighted in 1953. The term 'soluble' is here defined as: 'Capable of dissolving, i.e., of forming a single, homogenous phase with a specified solid or liquid.'

"Q. What does the term phase mean, if I may ask?

"A. A single state. Actually I use the word state normally in my own definition. A one-phase condition is a one-state condition.

"Q. A one state of matter?

"A. One state of matter in a physical sense.

"Q. Please proceed.

"A. And 'insoluble' is here defined as 'Not dissolving

in a solvent (except in minute amounts).'

- "Q. Now, what do you understand, if any, is the difference between 'substantially insoluble' and 'practically insoluble?'
- "A. Well, the two are relative terms and in a practical sense, as here defined, insoluble indicates that very minute amounts may still be dissolved in the solution or in the solvent, but from a practical standpoint relatively insoluble.

"Q. Then you have answered my next question: Is the

term 'soluble' a relative or an absolute term.

"A. The word soluble itself?

"Q. Yes.

"A. Well, the word soluble is not a quantitative expression as such, if I may say that, it is a relative one and that it would allow for a wide variance in the amounts of materials that would dissolve.

"Q. And does that also apply to the term insoluble?

"A. Yes, again in a relative sense insoluble as taken for the practical meaning would allow minute amounts of material, small amounts of material to be dissolved depending on the practical application that we are considering."

On cross-examination, with regard to this subject matter, Dr. von Fischer was asked the following questions and gave the following answers (RT 248):

"Q. Now, in defining solubility you relied in part on Exhibit S-42 which is the Van Nostrand Dictionary where the definition for insoluble is not dissolving in a solvent (except in minute amounts).

In the resin field what is a minute amount?

"A. This would depend on the conditions under which the resin is used. It is a practical consideration.

"Q. Would you state any condition, any practical consideration which would enable you to determine what a minute amount is and state what that practical consideration

is and then put a number on the minute.

"A. The practical consideration would be to use the resin in the application or type of application to which it would be used, or its industrial purpose, to see whether or not it would work satisfactorily, and this could not be related with a number figure."

On this same subject matter, Dr. von Fischer was asked the following questions and gave the following answers (RT 250):

- "Q. Now, with reference to the insolubility which has the minute amount and the soluble definition which doesn't define the amount, in between those two concepts of soluble and insoluble we have the concept that something is substantially insoluble, don't we?
- "A. Yes, substantially insoluble is certainly approaching the insoluble as here defined.
- "Q. Now, something that is substantially insoluble to you as a chemist means something that is less insoluble than something that is insoluble, does it not?
 - "A. Yes, in a relative sense that is correct.

"Q. Now, have you made any-

"A. I am very sorry, will you restate that question?

"Q. Well, I will restate the question that when we consider the academic concept that something is soluble and we consider the academic concept that something is insoluble,

we have those pretty well defined, as I understand your testimony, once we know the meaning of the word minute, but we now know what soluble and insoluble is. Now, we want to find out what the meaning of the words 'substantially insoluble' is under the definitions which you have used here and that would be something in between, something which is insoluble and something which is soluble, would it not?

"A. Yes, but approaching the side that is insoluble.

"Q. Approaching the side that is insoluble. In other words, if something is substantially insoluble there would be more than minute amounts of a product in the solvent, would there not be?

"A. Yes, could be slightly more than in the insoluble.

"Q. All right. Now, how much slightly more than minute in your definition would one get before one changes from something which is substantially insoluble to something which is soluble?

"A. This again is relative and depends on the practical

usage to which it is put.

"Mr. Sherman: May I interpose an objection to this line of questioning? If by the questions the attorney for Radiant is trying to get this witness to define 'substantially' within the meaning that it is used in the claims of the patent in suit, that is for the construction of the Court.

"THE COURT: That may be and we will so regard the

testimony.

"MR. HOPPE: Q. So this would be a relative term, then,

as far as you are concerned?

"A. Yes, depending on the use, the practical usage of the material under consideration."

With specific reference to the claims of the patent, Dr. von Fischer was asked the following questions and gave the following answers (RT 253):

"MR. HOPPE: Q. I said in viewing the fact that you want to have a completely condensed thermoplastic resin which has these three ingredients, melamine, sulfonamide and the aldehyde in which you're told that the amount of melamine should not exceed 50 percent by weight and that you should have a sufficient amount of this melamine to render a condensation product substantially insoluble in

aromatic hydrocarbon solvents—understand what I am talking about so far?

"A. Yes.

"Q. Now, in that context do the words 'substantially insoluble' mean the same to you as they have meant in your oral testimony thus far?

"A. Yes. If I were to read this in a patent or in an advertisement of Switzer Brothers I would assume that these materials are basically insoluble and can be used in products

for which pigments generally are used.

"Q. Yes. And in your testimony when you said that you thought that the products were insoluble you were not giving a different meaning to the word insoluble than you're giving right now in the reading of the words 'substantially insoluble' in that claim?

"A. Still depending on the use to which it is applied."

On the foregoing evidence, Switzer's representation that the critical limit remains the same, cannot be accepted as accurate. Again, there are such admitted variables as "It depends on your use and your customer"; "This again is relative and depends on the practical usage to which it is put"; ". . . depending on the use, the practical usage of the material under consideration."; and ". . . depending on the use to which it is applied" which must be considered in defining the limits of the patent claims. The critical limit does not remain the same as Switzer so glibly represented to this Court on the first appeal.

Thus, Switzer has now proved the same facts as those which Radiant unsuccessfully sought to bring out on its motion for a new trial based upon the deposition of Zenon Kazenas. Radiant there sought to show that Zenon Kazenas, in the infringement action brought against Lawter Chemicals, Inc., testified (OR 163):

"Q. Where would you place the main concentration of the amount of melamine or melamine formaldehyde that could be employed in the manufacture of the resin?

"A. I think it would be very difficult to place. You would have to place it depending upon what you wanted to do with

the final resin that was obtained.

"Q. Let us say that we wanted to grind the resin up to form a pigment.

"A. Well, there again, where the pigment would be used, it would be a factor whether it is going to be used in a strong solvent or a weak solvent.

"Q. Will you explain to me, then, what the limitations would be as compared to what solvents you would employ?

"A. I would say for our purpose we would want something that was substantially insoluble in aromatic solvents and the aliphatics.

"Q. And what amount of melamine or melamine formaldehyde would be required to give you that characteristic?

"A. I don't think you could pin it down to one definite per cent, because there is a wide variety of aromatic solvents. What I might choose in one particular aromatic solvent might not be useful in another and so I wouldn't pin it down to any definite per cent.

"Q. I will let you select the aromatic solvent and give me

the per cent for it.

"A. I don't believe I can do that, because I have not performed a sufficient number of experiments to pin it down that closely. I wouldn't want to hazard any guesses without doing the work on it.

"Q. And you would prefer to leave the lower limit in-

definite, is that right?

"A. Yes, I think that would be my idea."

Switzer successfully argued at page 71 of its brief that Radiant "should not be permitted to use, as evidence here, testimony of Mr. Kazenas taken in discovery in a different suit." Yet, Switzer on these contempt hearings has proven precisely that which Radiant sought to prove on the earlier motion. Such a change in circumstances should suffice, we submit, to illustrate the clear error into which Switzer led the District Court on the original trial and led this Court on the first appeal.

The circumstances which Switzer has now interjected into this case in order to redefine "substantially insoluble" were not before this Court on the first appeal except by indirection. On the first appeal, Radiant argued at length that the words "sufficient" and "substantially insoluble" are too indefinite to support the patent monopoly citing Vitamin Technologists v. Wisconsin Alumni Research F. (9 Cir. 1944, as amended 1945), 146 F. 2d 941; Barkeij v. Lockheed Aircraft Corp. (9 Cir. 1954), 210

F.2d 1; and *United Carbon Co. v. Binney Co.* (1942), 317 U.S. 228 (Appellants' Opening Brief on first appeal, pp. 90-95). Switzer in its brief for Defendant-Appellee did not answer these authorities nor did it answer the argument based upon such authorities, all as was pointed out in Appellants' Reply Brief, pp. 10-11. This Court did not touch upon the argument in its first opinion. The new circumstances, Radiant submits most respectfully, confirm the fact of the indefiniteness upon which Radiant relied and the applicability of Radiant's authorities.

Switzer's experts have now proved that the present case cannot be distinguished in principle from any of the cited authorities. By way of example, in United Carbon Co. v. Binney Co. (1942), 317 U. S. 228, the patentee relied in part on "a rough and ready test" to identify the patented product which consisted in testing the product for survival under gentle rubbing of the fingers. Such a test corresponds to the rough and ready test of substantial insolubility now suggested by Switzer. On another factor, that of friability, the Court said, page 233, ". . . The correct degree of friability can be ascertained only by testing the performance of the product in actual processes of manufacture of products of which carbon black is a component." Switzer's experts have now shown that the correct degree of solubility can be ascertained only by testing the performance of the product depending upon the use, the practical usage of the material under consideration and the demands of the consumer. Under the analogous facts thus discussed, United Carbon held the claims there in suit bad for indefiniteness. Radiant, therefore, submits that Switzer has shown that the facts in this case render the claims indefinite under the rule of United Carbon. Radiant submits that the claims should be held invalid on that basis.

Switzer's proofs also show that there is a true parallel between the present record and the record in *Vitamin Technologists v.* Wisconsin Alumni Research F. (9 Cir. 1944, as amended 1945), 146 F.2d 941. In that case, the novelty in the claim provided for the irradiation of food products by ultra-violet rays "for a period sufficient to effect antirachitic activation but so limited as to avoid subsequent substantial injury" to the product (146 F.2d 947).

This Court held those claims to be invalid because of indefiniteness of the area of the claimed monopoly. The patentee testified that the phrase "might have different meanings according to the economic or physiological conditions which may be present in any situation" (146 F.2d 950), just as Switzer's experts here have testified that the term "substantially insoluble" might have different meanings depending upon the end use of the product and the needs of the customer. This Court held the claims invalid for failure to comply with U. S. Code, Title 35, former Section 33 (now Section 112) on the authority of *United Carbon Co. v. Binney Co.* (1942), 317 U. S. 228 and *Gen. Electric Co. v. Wabash Co.* (1938), 304 U. S. 364. With reference to the words "sufficient" and "substantial", the Court had this to say, page 951:

"It is contended that there would be difficulty in stating with definiteness the amount of the functions of exposure which would be 'sufficient' or 'substantial.' Such a difficulty shows the doubt which would affect the minds of all other investigators and prospective inventors in the field. . . ."

Switzer's new proofs have further made it clear that there is a true analogy between the facts in this case and the facts in *Hall Laboratories v. Economics Laboratory* (8 Cir. 1948), 169 F.2d 65. That case referred to washing compounds in which one of the ingredients was a metaphosphate. At page 68, the Court said:

"The evidence is that the terms 'alkali-metal metaphosphate' and 'a deflocculative detergent capable of peptizing greases' used in claim 28 of Patent Re 19719 are descriptive and understandable to those skilled in the art but the uncertainty of the claim is in the application of the limitation 'which is water soluble and capable of sequestering calcium in a but slightly ionized condition' to the ascertainment of what amounts of which alkali metaphosphates are intended to be claimed. Likewise, in claim 10 of Patent 2035652 the limitation 'the sodium hexametaphosphate being in amount sufficient to prevent the precipitation of calcium soap in the washing of greasy articles in such highly alkaline solution' is a quantitative limitation. Under 28 there must be the right kind and enough of a metaphosphate to be water soluble and capable of the stated sequestration of calcium, and under 10 enough of the sodium hexametaphosphate to function in one circumstance and then enough to function in another, and there is no specification of proportions identifying the claims with a particular new composition. Therefore a given composition can not be established as infringing either claim 10 or claim 28 without resorting to a performance in use test because in each the product is described in terms of functions. The claims use functional language at the point of novelty. . . ."

Later in its decision, the Court said, page 69:

"... it is in fact necessary to resort to use and experiment to determine whether or not a composition makes use of the discoveries claimed in these patents. The insufficiency of the claim descriptions appears therefore as an actual fact constituting a real impediment to practice of the art so that it is not necessary to rely on the abstract declaration of law or statement of doctrine of the cited case."

The Court there had reference to Gen. Electric Co. v. Wabash Co. (1938), 304 U. S. 364.

Further, in Standard Oil Co. v. Tide Water Associated Oil Co. (3 Cir. 1946), 154 F.2d 579, the court held invalid as being indefinite a claim for a process of removing sulphur from motor fuels which consisted of contacting the fuel "with sulphuric acid of such strength and quantity as to have the capacity at low temperatures of selectively removing a part of the sulphur bodies and to polymerize a further part of said bodies and to effect a material rise of temperature of reaction unless restrained" (154 F.2d 580-581). The court held such claims invalid for failure to comply with the rules laid down in Gen. Electric Co. v. Wabash Co. (1938), 304 U. S. 364; United Carbon Co. v. Binney Co. (1942), 1317 U. S. 228; and Standard Brands v. Yeast Corp. (1939), 308 U. S. 34. In applying the statute and the cases, the Court said, pages 582-583:

"... The public policy behind the statute may be seen to be as strongly grounded in the necessity for adequate notice as it is in the necessity to teach. The burden is on the inventor to say precisely what he has done. He must speak so clearly that he does not shift that burden to others who because of his failure to be more explicit may unwittingly invade the field covered by the patentee.

"The most immediate test of sufficiency of precision in description following from the policy just outlined is that no inventor may compel independent experimentation by others to ascertain the bounds of his claims. This Court in the Standard Brands case so ruled before and the Supreme Court in the same case agreed. Equally necessary in derivation is the rule that difficulty in securing exactness does not mean a description may fall short of the requirements of the statute...."

Switzer has now proved that the general description does not define the invention

The next reason which this Court assigned for sustaining the validity of the claims is set forth at 299 F.2d 160, 166:

"Nor can it be said that this failure to specify the critical limit precisely results in a fatal vagueness of description. The claim must be sufficiently clear to allow others to reproduce the result at the end of the monopoly period and to enable contemporary inventors to ascertain whether or not they are infringing.

"Upon this point the district court concluded:

When the general description, the specific examples, and the claims are read together, the invention is so plainly defined that no one skilled in the art should have any difficulty in practicing it.'

The record supports this statement. . . . "

Switzer, on the contempt hearing, has now disowned any construction of the prior record which supported the conclusion that "the invention is so plainly defined" in the general description of the Kazenas patent. With regard to the general description upon which the District Court relied, as shown in the quoted material, Switzer now shows that those portions of the record which it urged earlier as support for the claim actually are in contrast with the claim limitation.

At the original trial, on cross-examination, Dr. Hatcher was asked the following questions and gave the following answers (OR 423-424):

"Q. Where do you find in the Kazenas patent a teaching that the solubility in aromatic hydrocarbon solvents is keyed to the quantity of melamine?

"A. In reading the entire patent it gives that impression, that enough melamine is required to achieve that result.

'Q. Would you please read one sentence that gives that

expression?

"A. I did in just reading the first column, starting about Line 30, it is speaking of the thermoplastic resin, and it says down about Line 43, 'On the other hand, the new resin, unlike the melamine-aldehyde resins, is soluble in certain solvents and is thermoplastic.'

No, that isn't the one I was searching for.

"Q. Do you find any language in there referring to insolubility in aromatic hydrocarbon solvents?

"A. Not there. In the patent I do. I find it in a number

of places.

"Q. Well, let's find one.

"A. Let's take Column 1, Line 57:

'The new resin is insoluble in many common vehicles and can therefore be suspended in such vehicles without coalescence or agglomeration.'

The common vehicles are, normally, of an aromatic na-

ture."

On redirect examination, he was asked the following questions and gave the following answers (OR 468-469):

"Q. Dr. Hatcher, you were also asked if you would examine the Kazenas patent and find any statements relating

to-Oh, strike that question.

You were asked to examine the Kazenas patent and find any statements which would lead you to believe that the melamine content of the Kazenas resin was such that it was insoluble in aromatic hydrocarbon solvents, and you did examine the patent during the recess but you were not asked the question again on cross-examination. I will ask it to you now.

"A. Yes, I find four references to it.

"Q. Could you read those, please?

"A. On Column 1, line 57, it says:

'The new resin is brittle and friable below its softening point'—No, that's not it. 'The new resin is insoluble in many common vehicles and can therefore be suspended in such vehicles without coalescence or agglomeration.'

Then going to Column 5, the portion that we just read where it says, 'If desired, the undyed resin may be pre-

pared as in Examples 1 to 6 and dyed by immersion in an aqueous dye bath,' which refers on to Column 6 where it

says at line 4:

'The pigments prepared in the manner described in [232] the foregoing examples are insoluble in water and aliphatic hydrocarbon solvents, are practically insoluble in aromatic hydrocarbon solvents, and are soluble in ketones and solvent esters.'

Then in that same column, line 21,

'Based on these physical characteristics, the pigments may be used in vehicles which are non-solvents for the pigments to form various types of inks and the like.'

These would lead to the very strong conclusion that they

are unsoluble in aromatic solvents."

On recross-examination he was asked the following question and gave the following answer (OR 474-475):

"Q. (By Mr. Hoppe): Dr. Hatcher, to a man skilled in the art, is there any difference between being soluble in common vehicles and the usual solvents? This is without reference to the patent. I am just asking you about the words 'common vehicles' and 'usual solvents.'

"A. There could be some difference, slight difference. Here I am sure it is meant in that manner, however."

Clearly, Dr. Hatcher there told the District Court that there was a true relationship between the words "substantially insoluble in aromatic hydrocarbon solvents" and the words "the new resin is insoluble in many common vehicles and can therefore be suspended in such vehicles without coalescence or agglomeration." Indeed, this Court so considered the description in the specification. For example, this Court found (299 F.2d 162-163), "The Kazenas patent is for a resin . . . which remains insoluble without agglomeration in aromatic hydrocarbon solvents."

In the Brief for Defendant-Appellee, Switzer positively pointed out to this Court, page 23:

"The insolubility of the resin in aromatic hydrocarbons which may be used as paint vehicles is critical in this situation (R. 397). The resin must be so insoluble that its particles do not agglomerate—i.e. remain free-flowing—if they are to function satisfactorily as discrete pigment particles (R. 400)."

Later, at page 37 of its brief, Switzer argued:

"... With respect to the limitation in question, on direct examination (R. 395) Dr. Hatcher positively testified that the Kazenas patent teaches 'there must be sufficient melamine content to cause insolubility in aromatic solvents'; and he reaffirmed his position in answer to a cross-examination question (R. 468-469) by quoting passages from the Kazenas disclosure in detail. Later in its brief (R.O.B. 79), Radiant even quotes this portion of Dr. Hatcher's testimony with approval."

Now, on the contempt proceedings, Mr. Gray testified that the expression "practically insoluble in aromatic hydrocarbon solvents" means that "They have a very low solubility in those solvents." (RT. 72) and the expression "The new resin is insoluble in many common vehicles and can therefore be suspended in such vehicles without coalescence or agglomeration" means that ". . . these resins can be used as pigment resins in the common paint vehicles, can be redispersed after standing for some period of time." (RT. 73).

At RT. 74, Mr. Gray further stated the following:

"Mr. Sherman: Q. Now, what distinction, if any, do you draw between these two quotations, one with reference to aromatic hydrocarbon solvents and the other to the common vehicles?

"A. Aromatic hydrocarbon solvents would be the pure solvents, and the patent states that they shall be practically insoluble in those materials. With respect to the vehicles, they say again that they are to be insoluble in those common vehicles, and in other language which I interpret to mean that they can be redispersed.

"Q. And that other language is 'without agglomera-

tion'?

"A. Suspended in such vehicle without coalescence or

agglomeration.

"THE COURT: Now, I still don't understand the testimony. You say that the language of the patent is 'Practically insoluble in aromatic hydrocarbon solvents' has reference to what are called pure solvents?

"THE WITNESS: Yes, sir.

"THE COURT: Now, by way of contrast to that, what you are telling me now with reference to the language of the patent to the effect that it is insoluble in what?

"THE WITNESS: Common paint vehicles."THE COURT: Common paint vehicles?

"THE WITNESS: An aromatic hydrocarbon solvent is not in and of itself used as a paint vehicle. It has no binding power. If it were so used the dry pigment would powder off at the surface upon evaporation of the solvent. Accordingly, the paint vehicle must have incorporated in it a resin or binding medium which will serve as a glue to hold the pigment to the surface when the solvent evaporates.

"THE COURT: A medium to hold what?

"THE WITNESS: The pigment to the surface to which

applied after the solvent has evaporated.

"MR. SHERMAN: Q. And that is true, is it, even in a case where the pigment is itself a melamine sulfonamide formaldehyde resin?

"A. Yes.

"THE COURT: In other words, if I understand it, you are drawing a distinction between solubility in pure solvents on the one hand and solubility or insolubility in connection with common paint vehicles, which comprise not the pure solvents themselves, but pure solvents with some kind of binder added?

"THE WITNESS: Right, Your Honor.

"THE COURT: All right."

Thus, an important portion of the specification which Switzer relied upon for antecedent support to the claims (an essential to make out a case of validity in the first instance) has now been shown to contrast with and be distinct from the expression "substantially insoluble in aromatic hydrocarbons". With that portion of the written description eliminated from an understanding of what the claims mean, the claims themselves become meaningless. Switzer thus has proved that it led this Court into error in originally concluding that the claims were supported by and made definite by the general description and examples.

Switzer has now proved that there is no simple clear test to determine substantial insolubility

On the first appeal, this Court continued its discussion, page 166:

". . . . There is testimony to the effect that 'sufficient melamine to render the resin substantially insoluble' is a simple,

clear test for an ordinary chemist to perform and one which does not require extensive experimentation in order that the precise critical limits be ascertained in a particular case. Under such circumstances, the fact that some preliminary testing is required does not render the claim invalid for vagueness. Mineral Separation, Limited v. Hyde, 1916, 242 U.S. 261, 37 S.Ct. 82, 61 L.Ed. 286."

On this point also, Switzer, on the contempt hearings, destroyed the factual premises upon which this Court based its earlier decision.

This Court's reference to "testimony to the effect that 'sufficient melamine to render the resin substantially insoluble' is a simple, clear test for an ordinary chemist to perform and one which does not require extensive experimentation in order that the precise critical limits be ascertained in a particular case." is based upon the following testimony of Dr. Hatcher (OR 397):

"Q. (By Mr. Manahan): What, if anything, is critical about the solubility of a resin used as a pigment?

"A. It is necessary that it be sufficiently insoluble that it will not agglomerate in the vehicle that is used.

"Q. How difficult is the solubility test for a resin?

"A. It is not difficult. It is readily observable."

Counsel then identified the results of four solubility test experiments, to-wit Exhibits L, M, N, and O. With respect to the Japanese experiment, Dr. Hatcher testified (OR 399):

"Q. (By Mr. Manahan): Did you follow exactly the procedure set forth in the Japanese Patent?

"A. The procedure in the Japanese Patent was followed explicitly.

"Q. What was the solubility of the resulting resin?

"A. It was soluble in toluene."

With respect to the patented resin, Dr. Hatcher testified (OR 400):

"Q. Have you ever carried out the procedure of the Kazenas Patent, Example 5?

"A. Yes, I have.

"Q. Do you have an example of the resin obtained?

"A. Yes, I have. It is Exhibit N—N as in Nelly, your Honor.

"Q. What is the softening point of that resin?

"A. As I recall, it was 112 degrees Centigrade.

"Q. What was the solubility of this resin in toluene?

"A. It was insoluble in toluene.

- "Q. How can you tell?
- "A. By dispersing it in toluene and leaving it. It did not agglomerate. It remained free-flowing.

"Q. When was this resin prepared?

"A. It was prepared in late August, 1958.

- "Q. Have you had that sample under your watch and care ever since?
 - "A. I have had it in my possession since that time.

"Q. Is the resin still insoluble?

"A. The resin still is insoluble. It is free-flowing."

With respect to the ease of the experiments, Dr. Hatcher testified (OR 405):

"Q. Now, Dr. Hatcher, how difficult is it for a chemist to repeat an amide condensation and obtain the same results time and again?

"A. Once the procedure has been standardized it can be

done with ease.

"Q. Would the results be identical each time?

"A. Not entirely. They could vary in slight manner, but they would not be altered by any large amount."

Switzer called the attention of the foregoing testimony to this Court in support of the original appeal in its Brief for Defendant Appellee, pages 9-10:

". . . Dr. Hatcher explained to the Trial Court that when he dispersed the Kazenas Example 5 resin in toluene: 'It did not agglomerate. It remained free-flowing' (R. 400).

"This initial toluene insolubility test for the Kazenas resin of Dx. N had been carried out some four months before the trial (R. 401), yet Dr. Hatcher was able to demonstrate these test results to the Court at the time of trial since the resin was still free-flowing in Dx. N (R. 401)..."

At page 22, Switzer again referred to this testimony:

"... the District Court had an opportunity to hear extensive testimony by Dr. Hatcher (R. 398-401) concerning the Japanese patent and experiments which he had made in connection therewith...."

Again referring to this testimony on page 23, Switzer had this to say:

"The insolubility of the resin in aromatic hydrocarbons which may be used as paint vehicles is critical in this situation (R. 397). The resin must be so insoluble that its particles do not agglomerate—i.e. remain free-flowing—if they are to function satisfactorily as discrete pigment particles (R. 400)."

There is nothing ambiguous or indefinite in the standard thus laid out. Dr. von Fischer had no difficulty in understanding what Switzer and this Court as well had said. He was asked the following questions and gave the following answers (RT 256):

"Q. Now, I pose this hypothetical situation to you, Dr. von Fischer, and that is that instead of the words 'substantially insoluble' having anything to do with dictionary meanings that you are informed that the words 'substantially insoluble' in aromatic hydrocarbon solvents mean this: That the resin is capable of being finely ground, deposited in an aromatic hydrocarbon solvent, and that in order to meet that definition it must remain suspended without agglomeration or coalescence. Now, assume that that is the definition which is to be put on 'substantially insoluble', then how long would you have to permit the product to stand in a suspended condition before you would be satisfied that it was substantially insoluble?

"A. Well, as you state the supposition this would be infinite, an infinite period of time.

"Q. As I stated the supposition the way you understand what I said it would have to be forever?

"A. Forever."

After Switzer learned that the three components in the accused resin did not fulfill the tests upon which it once relied, it urged the District Court to ignore solubility tests where the resin agglomerates by reason of its "sensitivity". In doing so Switzer proved that a test of whether or not a resin remains free-flowing is meaningless and unimportant.

Significantly, Dr. Hatcher did not so testify. Switzer brought in Dr. von Fischer to make a new series of experiments. His main series consisted of quantitative solubility measurements of resins

in the three solvents in which the examination was made at the end of 24 hours (RT 212-213). He testified that 24 hours is certainly more than adequate (RT. 235). In all cases, he used a maximum of 24 hours and made no determination at all to determine whether it is a fact that equilibrium is reached in 24 hours (RT. 247).

At RT 255, he was asked the following questions on cross-examination and gave the following answers:

"Q. And let us say that the material agglomerates in 36 hours. Would you then say that the material is soluble or insoluble?

"A. I would say the agglomeration is not due to solubility, but sensitivity to the solvent.

"Q. Now, I pose this hypothetical question to use, that instead of the—

"THE COURT: Wait a minute. What did he say? If the agglomeration should occur after 24 hours you would say—?

"THE WITNESS: That it would not be an indication of

solubility, but sensitivity of the resin to the solvent.

"MR. HOPPE: Q. And that is because in part you have concluded that equilibrium will be reached in 24 hours and whatever happens after 24 hours is due to something else?

"A. I had indicated that I believe that you would get what would be termed a saturated solution considerably before 24 hours and certainly a 24-hour period would be adequate."

Dr. von Fischer's positive distinction between solubility and sensitivity to the solvent is at direct variance with that which Switzer proved on the original trial. At that trial, Switzer found it necessary to read meaning into the words "completely condensed" by reproducing Example 5 of the Kazenas patent but using less formaldehyde than was called for in the patent example. At page 55 of its opening brief, Switzer told this Court on the first appeal:

"Actually, of course, the mere addition of melamine to a melamine-sulfonamide-formaldehyde resin that is soluble in toluene, does not in and of itself render the resulting resin insoluble in toluene. That was established by Joseph L. Switzer (R. 514-15) by adding enough melamine to the

Japanese resin to bring the total melamine content up to 13%. The resulting resin was 'still very sensitive to toluene' (R. 515)."

Thus, on the first appeal, sensitivity to toluene and solubility in toluene were treated as one and the same—to make out contempt a distinction had to be drawn.

Phrases which are susceptible to such opposite meanings, being synonymous at one time and distinct at another time, do not serve the purpose of particularly pointing out and distinctly claiming the invention. This is particularly true in this case. Here the meaning of the phrase in the claims must be inherent in the specification for otherwise, there would have been no warrant for adding the claims late in the prosecution of the patent application.

Switzer has now proved that aromatic solvents are indefinite

The record on the contempt hearings establishes still another area in which the claims are ambiguous and fail to particularly and distinctly claim the invention. At the time of the first appeal, it seemed perfectly clear to this Court, as is manifest from the first opinion, that there was nothing mysterious in the phrase "aromatic hydrocarbon solvents." This Court was able to treat the phrase generically and it did so many times in its original opinion. Typical expressions are:

"The Kazenas patent is for a resin . . . which remains insoluble without agglomeration in aromatic hydrocarbon solvents." (299 F.2d 162-163)

"The Japanese resin . . . is soluble in aromatic hydrocarbons, while the Kazenas resin is substantially insoluble." (299 F.2d 163)

- "... The feature to which this contention [late claiming] is specifically addressed is the resin's insolubility in aromatic solvents." (299 F.2d 166)
- "... What it [Radiant] requires is that which the Kazenas resin provides: completeness of co-condensation and insolubility in aromatic solvents." (299 F.2d 168)

Similarly, the District Court, in treating of aromatic hydrocarbon solvents, repeatedly used that phrase in a generic sense

(OR 125, 126, 130, 131, 132, 133, 135, 136, 137, 138) although it mentioned the three basic aromatics, benzene, toluene and xylene specifically in its discussion of the merits of the controversy (OR 130, 136).

Switzer has now contended, to the satisfaction of the District Court on the contempt proceedings, that benzene must be excluded from the generic phrase "aromatic hydrocarbon solvents." In support of this contention, its vice-president, Dr. von Fischer, testified (RT 220):

"Q. Now, do you have any authority in the literature for your statement that benzene is not used as is toluene

and xylene as solvents in paint vehicles?

"A. Yes, I think in numerous publications the statement will appear that benzene, although an aromatic hydrocarbon solvent, is generally not used because, first of all, it is highly toxic; secondly, it is a very rapidly evaporating material which is often not desirable; thirdly, it's hazardous also from the standpoint that it has an extremely low flash point, is the term, one that is almost zero degrees Fahrenheit; and in addition the atmosphere in which the benzene vapor might appear easily becomes an explosive mixture. It has a very low percentage content giving an explosive mixture. As I recall it's on the order of one point four percent. Benzene vapor in an atmosphere can make the entire atmosphere an explosive mixture. Therefore, it is not really a practical solvent."

In support of this testimony, Switzer offered its Exhibits S-40 and S-41.

On cross-examination on this subject matter, Dr. von Fischer testified in part as follows (RT 287):

"Q. Now, I would like to turn to aromatic hydrocarbon solvents. In 1954 what were the aromatic hydrocarbon solvents generally, Dr. von Fischer? They were Benzene, toluene and Xylene, weren't they?

"A. Sir, I am afraid I couldn't enumerate the long list of different types of aromatic hydrocarbon solvents that

were available in 1954.

"Q. Well —

"A. As they were innumerable.

"O. Well, in any event, Benzene, toluene and Xylene are three aromatic hydrocarbon solvents, aren't they?

They are three basic aromatic hydrocarbons.

Now, in addition to those three what other aromatic hydrocarbon solvents were there in 1954—and before you answer, I understand that there were many. Just give us five or six typical ones.

"A. The ones that I have reference to are mixtures of hydrocarbons generally classified under trade numbers, products of the Switzers as well as other people in the field, commonly used for aromatic hydrocarbon solvents. Referring to the Solvents and Chemical Groups designations, they have numbers like SC-2, SC-2A, SC-3, SC-100, SC-150.

"Q. Now, of the three aromatic hydrocarbon solvents that are known as Benzene, toluene and Xylene, have you any opinion as to which of those three is produced in the greatest quantity in this country?

"A. I am sorry, you say "produced" and not "used as

solvents."

"Q. I am sorry. My question is, which are produced in this country?

I don't have figures at hand, but I think it would "A.

be Benzene.

"Q. Now, is Benzene ever used as an aromatic hydrocarbon solvent?

Yes. Yes, it is at times.

"O. And in the Technology of Solvents and Plasticizers, I would like to read this into the record.

"THE COURT: What are you reading from? "MR. HOPPE: From Exhibit S-40, Your Honor.

'Benzene (Benzol), the simplest aromatic hydrocarbon, is a colorless liquid of characteristic, aromatic odor. It dissolves fats, waxes, gums, rubbers and cellulose ethers. Although sometimes employed as a component of stains, paint removers, cements, cleaners and lacquers, such solvent applications of Benzene are limited by its high volatility and toxicity.'

"MR. HOPPE: Q. Now, outside of the fact that that text says that the use of Benzene in lacquers is limited, is it not true that Benzene is extensively used, even though limited, as a solvent?

"A. Not in the paint industry.

"Q. Is it measurably used as a solvent in the paint

industry?

"A. I have no figures. I am sure there is a small quantity used in specialty finishes.

'Q. Where resins are also used?

"A. Where vehicle or binder resins are used.

"Q. So in specialty finishes you would concede that aromatic hydrocarbon solvents would include Benzene as one of the members of the aromatic hydrocarbon solvent family?

"A. Benzene is a member of the aromatic hydrocarbon series and, I have said, is used to a limited extent in paint

formulations—specialty type formulations.

"Q. Now, one of the reasons that you assign for not using Benzene yourself is that it is toxic, is that correct?

"A. That is correct.

"Q. And what does 'toxic' mean? That it's a poison?

"A. It is poisonous and has a very—a very small percentage of the Benzene vapor in the atmosphere has a drastic effect on the human system.

"Q. At this point I would like to read into the evidence from Defendant's Exhibit S-16, which is the toluene example, the following warning.

"THE COURT: Wait a minute. This is S-16, now?

"Mr. HOPPE: S-16, a bottle of toluene."
THE COURT: Just a bottle of toluene?
"Mr. HOPPE: Just a bottle of toluene.

"THE COURT: All right.

"MR. HOPPE: 'Warning: Flammable. Vapor harmful. Keep away from heat, sparks and open flame. Keep container closed. Use only with adequate ventilation. Avoid prolonged breathing of vapor. Avoid prolonged or repeated contact with skin. Do not take internally. Poison.'

"And I point out for the record that 'poison' on each side is delineated by two skulls and crossbones, and that the entire word 'poison' and the two skulls and crossbones are

red.

"MR. HOPPE: Q. And I will ask you if it is not true that toluene is also toxic?

"A. Yes, it is, but the tolerance limits are higher for toluene than they are for Benzene."

In thus construing the generic phrase "aromatic hydrocarbon solvents" as excluding benzene, Switzer has confessed, indeed it has proclaimed, that the claim language is broader than the invention in this critical area of novelty. In so doing, Switzer has also confessed that the claims are invalid for failure to comply with U. S. Code, Title 35, Section 112. Graver Mfg. Co. v. Linde Co. (1949), 336 U.S. 271 held that certain process claims calling for the use of "silicates" and "metallic silicates" did not comply with the statute because these claims were too broad and comprehended more than the invention. The court held that claims fail "to perform their function as a measure of the grant when they overclaim the invention." (336 U. S. 277). It cannot be gainsaid that the claim to "aromatic hydrocarbons" by definition includes benzene. Under the rule of Graver, Radiant submits that these claims are void and that in the interest of justice, this Court should so declare them at this time.

The intervening case law confirms invalidity of the claims

This Court, in its earlier decision, adopted Switzer's contentions that the law did not require it "to state the critical lower limits precisely" and that the law permitted "some preliminary testing" in order "that the precise critical limits be ascertained in a particular case." Most respectfully, Radiant submits that the sounder cases which have emerged since the earlier appeal show that these contentions of Switzer were, and they are, in error.

Judges Jertberg and Browning and District Judge Jamieson, in Nelson v. Batson (9 Cir. 1963), 322 F.2d 132, stated that "Precise claims are required" for reasons fully developed at 322 F.2d 134. Thus, this Court has now concluded that "the alternative" to which Switzer objected on the first appeal is not an alternative at all but, that to the contrary, it is a mandatory requirement of the patent law. Validity of the claims was not before the Court in Nelson, however, because the parties had entered into a consent decree that the claims were valid. This Court, therefore, precisely construed the claims to conclude that

a structure differing from the disclosure of the patent did not infringe that patent.

Senior Circuit Judge Hamlin sat by designation in, and thus gave a Ninth Circuit flavor to, H. C. Baxter & Bro. v. Great Atlantic & Pacific Tea Company (1 Cir. 1965), 352 F.2d 87 affirming (D.Me. S.D. 1964), 236 F. Supp. 601, cert. den. (1966), U.S. There, the court in a per curiam decision held that claims for a process patent of pretreating French fried potatoes so that they will fry to "a substantially even color" were invalid "because of the extent of experimentation required by one skilled in the art in order to ascertain their 'teaching'." The District Court decision thus affirmed shows, as analogous to the contention actually admitted by Switzer here, 236 F. Supp. 611:

". . . a person attempting to use the process could only ascertain the limitation by experimentation . . ."

The discussion of the statute and the case law, 236 F. Supp. 612, is at direct variance with the excuses which Switzer urged on the first appeal.

District Judge Hall, in McCulloch Motors Corporation v. Oregon Saw Chain Corp. (S.D. Cal. C.D. 1964), 234 F. Supp. 256, treated the statutory requirement as being of such importance that he declared invalid on its face on a motion for summary judgment mechanical patent claims using the indeterminate adjectives "long" and "short" to describe links in chain saws for sawing wood. He held that "evidence as to what someone skilled in the art would do with the patent" was inadmissible on this question of law (234 F. Supp. 259). Judge Hall relied on many of the same authorities upon which Radiant relied on the first appeal and which Switzer did not even attempt to distinguish (234 F. Supp. 259).

In Johnson & Johnson v. Kendall Company (7 Cir. 1964), 327 F.2d 391, the court categorically observed, after holding the patent invalid on other grounds, p. 396, that "It is well established that claim elements may not be functional at the point of alleged novelty." Yet, that is the admitted situation in the claims at bar.

That same court, in A R Inc. v. Electro-Voice. Incorporated (7 Cir. 1962), 311 F.2d 508, held a claim for a loudspeaker enclosure to be void where it differed from the prior art "by reason of the element or functional relationship set forth . . . in the closing clause" of the claim (311 F.2d 510). This functional relationship was related to the term "optimum resonant frequency" as used in the specification. As to this, the court held, page 512:

". . . Moreover, Villchur, in his deposition admits that the term 'optimum resonant frequency' which appears in the specifications expresses a definite value only in the sense of referring to the measure of distortion acceptable in connection with the use or purpose for which the speaker system is designed and intended or 'what power capabilities you want to achieve'. Such criteria does not meet the definiteness required of a valid claim. General Electric Co. v. Wabash Appliance Corp., 304 U.S. 364, 58 S.Ct. 899, 82 L.Ed. 1402."

Here, too, Dr. von Fischer and Mr. Gray have both made it quite emphatic that "substantially insoluble" expresses nothing other than that measure of insolubility acceptable in connection with the use or purpose for which the resin is to be used. As said in *AR Inc.*, "Such criteria does not meet the definiteness required of a valid claim."

Also pertinent is the decision of District Judge Watkins in Marshall v. Proctor & Gamble Maufacturing Company (D. Md. 1962), 210 F. Supp. 619. He there condemned claims using subjective, indeterminate, ambiguous and indefinite expressions to define novelty in the claims. At page 628, he said:

"The court recognizes that except where criticality is the essence of an invention, latitude in the expression of standards is permissible; but there should be some ascertainable standard. Here, instead of the vague 'good', 'substantially', 'freedom from objectionable', 'high', 'excellent'—the meaning of which is completely dependent upon how 'high' or 'low' the reader, or manufacturer, or consumer 'sets his sights', it would have been easy to state a basis upon which true comparisons could have been made. . . ."

At page 629 he said:

"Plaintiff, or his patent attorney, knew how to express 'evidences', or attributes, specifically. The failure to do so in the patent as issued seems deliberate. It appears to have been designed to permit plaintiff to apply his own definitions to these 'evidences,' and as so defined, elastically if necessary, to claim infringement."

How pertinent that thought is to the new experiments Switzer has here adduced to define what "substantially insoluble" and what "aromatic hydrocarbon solvents" now mean! At page 631, Judge Watkins said:

"The claims should point out the limits of the coverage of the patent. Where they do not, they fail in their purpose of describing the boundaries of the invention, within which no one may properly operate unless licensed under the patent; outside of which, the field is open to the public. Where such 'no trespassing' signs are not properly posted defining the protected boundaries, the claims are invalid."

In summary, since this Court's decision on the first appeal, this Court, and other courts as well, have recognized the inherent soundness of the rules and authorities which Radiant asked this Court to apply on the first appeal⁸ and the lack of merit in contentions such as those which Switzer advanced to avoid the clear mandate of U. S. Code, Title 35, Section 112. It is now established, Radiant submits, that the true rules to be applied are that claims

^{8.} United Carbon Co. v. Binney Co. (1942), 317 U.S. 228 is cited with favor or followed in Nelson (322 F.2d at 134), McCulloch Motors (234 F. Supp. at 259), and Marshall (210 F. Supp. at 630); Standard Brands v. Yeast Corp. (1939), 308 U.S. 34 is followed in Baxter (236 F. Supp. at 612) and Marshall (210 F. Supp. at 631); Gen. Electric Co. v. Wabash Co. (1938), 304 U.S. 364 is cited with favor or followed in Nelson (322 F.2d at 135 and 138), Baxter (236 F. Supp. at 612), McCulloch Motors (234 F. Supp. at 259), Johnson & Johnson (327 F.2d at 396), A R Inc. (311 F.2d at 511), and Marshall (210 F. Supp. at 630); Barkeij v. Lockheed Aircraft Corp. (9 Cir. 1954), 210 F.2d 1 is followed in McCulloch Motors (234 F. Supp. at 259) and Marshall (210 F. Supp. at 631); Vitamin Technologists v. Wisconsin Alumni Research F. (9 Cir. 1944, as amended 1945), 146 F.2d 941 is followed in Marshall (210 F. Supp. at 631); and Farmers' Cooperative Exchange v. Turnbow (9 Cir. 1940), 111 F.2d 728 is followed in McCulloch Motors (234 F. Supp. at 259).

must be precise at the point of novelty, that they may not define novelty in subjective and indeterminate words and that they cannot require any member of the public to experiment to discover the boundaries of the claims. Radiant submits, on the authority of *Helms Bakeries v. C.I.R.* (9 Cir. 1959), 263 F.2d 642, 644, cert. den. (1959), 360 U. S. 903, reh. den. (1959), 361 U. S. 857, discussed at page 43 above, that these intervening authorities warrant a reconsideration of this Court's earlier decision.

CONCLUSION

In conclusion, Radiant submits that the judgment of the District Court should be reversed upon both of the questions presented for review.

On the first question, Radiant submits that the record is clear that if the standards are applied which resulted in the original judgment of validity in this case, Switzer has not proven by any simple clear test that the accused pigment includes an amount of melamine sufficient to produce substantial insolubility in aromatic hydrocarbon solvents but that to the contrary, Radiant has proved the affirmative that the amount of melamine is insufficient.

On the second question, Radiant submits that the new circumstances which Switzer has introduced into the case conclusively establish that the claims do not meet the standards of U. S. Code, Title 35, Section 112, as interpreted by the current authorities. In the exercise of its discretion, this Court is respectfully urged to reconsider its earlier decision on this point and to direct the District Court to enter judgment holding the Kazenas patent invalid.

Respectfully submitted,

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Dated at San Francisco, California July 22, 1966

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CARL HOPPE,
Attorney for Appellants.





Appendix

LIST OF PLAINTIFFS' EXHIBITS

	Description	Identified	Offered	Received
R-C	Deposition of James T. Wayne	. 7	.128	430
R-D	Deposition of Daniel Bennahmias	. 8	429	430
R-1	Formula Sheet No. 5782 used in making typical 4-C pigment		369, 428	370, 430
R-2	Formula Sheet No. 8347 used in making Wayne test resin		369, 428	370, 430
R-3	Jar containing toluene-sulfonamide used in making Wayne test resin		371, 428	371, 430
R-4	Jar containing paraformaldehyde used in making Wayne test resin	. 370	370, 428	370, 430
R-5	Jar containing melamine used in making Wayne test resin	. 371	371, 428	371, 430
R-6	Jar containing unground Wayne test resin	. 371	371, 429	430
R-7	Jar containing powdered Wayne test resin	372	429	430
R-8	Jar containing Wayne test resin in benzene	. 378	429	430
R-9	Jar containing Wayne test resin in toluene	384	429	430
R-10	Jar containing Wayne test resin in xylene	388	429	430
R-15	Test tube containing unground Bennahmias test resin		429, 508	430, 508
R-16	Test tube containing powdered Bennahmias test resin		429, 508	430, 508
R-17	Test tube containing Bennahmias test resin in benzene		429, 508	430, 508
R-18	Test tube containing Bennahmias test resin in toluene		429, 508	430, 508
R-19	Test tube containing Bennahmias test resin in xylene		429, 508	430, 508
R-25	Time-Temperature Graph showing reaction of Wayne test resin		370, 429	370, 430
R-28	Jar containing Kazenas Example 2 resin in acrylic vehicle			*****
R-29	Jar containing Kazenas Example 4 resin in acrylic vehicle			_
R-30	Defendant's Exhibit L, a resin of Example 5 of Kazenas patent but with 5% melamine instead of 13%	:	639A	639A

	Description 1	Identified	Offered	Received
R-31	Defendant's Exhibit M, a jar containing Japanese resin but made with more formaldehyde	152	640	640
R-32	Defendant's Exhibit N, a jar containing Example 5 of the Kazenas patent	153	640	640
R-33	Defendant's Exhibit O, a jar containing example of prior art Japanese resin	154	640	640
R-34	Defendant's Exhibit P, a jar containing Example 5 of the Kazenas patent	175	640	640
R-37	Time-Temperature Graph showing reaction of typical 4-C pigment	344	366	370
R-38	Test tube containing 4-C pigment in benzene, prepared July 2, 1963	374	376	376
R-39	Test tube containing 4-C pigment in toluene prepared around July 2, 1963	376	378	378
R-40	Jar containing resin prepared following Example 5 of Kazenas patent but using formaldehyde and sulfonamide in equa-molar proportions		509	509
R-41	Jar containing R-40 resin in toluene prepared as courtroom demonstration	397	509	509
R-42	Jar containing R-40 resin in toluene prepared 10/8/65		509	509
R-43	Test tube containing a 7-4-1 resin (designated JS 738) in benzene, prepared 7/13/63	404	509	509
R-44	Test tube containing a 7-4-1 resin (designated JS 738) in toluene, prepared 6/28/63	407	509	509
R-45	Formula Sheet No. 5781 covering an abortive batch of pigment		640	641
R-46	Test tube containing 7-4-1-0.5 resin (designated JS 739) in benzene, prepared 7/13/63		640	641
R-47	Test tube containing a 7-4-1-0.5 resin (designated JS 739) in toluene, prepared 6/29/63		640	641
R-48	Tabulation of quantitative solubilities of resins	531	535	535
R-49	Chart of solubility versus time for Japanese resin stirred in toluene at room temperature		641	641
R-50	Chart of solubility versus time for Japanese resin stirred in xylene at room temperature		641	641
R-51	Chart of solubility versus time for R-40 resin stirred in toluene at room temperature		543	543

	Description	Identified	Offered	Keceived
R-52	Chart of solubility versus time for R-40 resin stirred in xylene at room temperature		543	543
R-53	Chart of solubility versus time for R-40 resin standing in toluene		548	548
R-54	Chart of solubility versus time for Wayne resin stirred in benzene at room temperature		641	642
R-55	Chart of solubility versus time for Wayne resin stirred in toluene at room temperature		641	642
R-56	Chart of solubility versus time for Wayne resin standing in benzene at room tempera-		641	(42
70	ture		041	642
R-57	Graph of reaction temperature for Wayne resin		642	642
R-58	Chart of reaction for Gray resin S-5	600	642	642
R-59	Chart of Kazenas claim 2 and comparison with Japanese resin		_	

LIST OF DEFENDANT'S EXHIBITS

	Description	Identified	Offered	Received
S-1	Jar containing sulfonamide used in making Gray test resin		120	120
S-2	Jar containing formaldehyde used in making Gray test resin	120	120	121
S-3	Jar containing melamine used in making Gratest resin		121	121
S-4	Jar containing unground Gray test resin	121	121	121
S-5	Jar containing powdered Gray test resin	121	121	122
S-6	Test tube containing Gray test resin in ber zene		196	197
S-7	Test tube containing Gray test resin in toluen	ie 198	199	200
S-8	Test tube containing Gray test resin in xylen	e 200	200	200A
S-9	Log sheet made during reaction of Gray terresin		124	124
S-10	Notice of taking deposition, 9/25/65	125	125	125
S-11	Deposition of Mr. Gray and Dr. von Fischer	125	125	126
S-12	Bulletin by Radiant	59	59	60
S-13	Bulletin by Radiant on Velva-Glo	62	63	64
S-14	Copy of patent in suit	73	73	74
S-15	Jar containing Japanese resin made in March April, 1958		78	78
S-16	Bottle of toluene	79	117	117
S-17	Jar containing Japanese resin in toluene	82	117	117
S-18	Test tube containing resin of Example 3 of Kazenas patent in toluene		117	118
S-19	Test tube containing resin of Example 1 of Kazenas patent in toluene		118	118
S-20	Test tube containing resin of Example 6 of Kazenas patent in toluene		118	118
S-21	Test tube containing Japanese resin in toluer	ne 94	118	119
S-22	Jar containing Example 1 resin in alkyd vehicle	104	112	113
S-23	Jar containing Example 1 resin in acrylic vehicle	104	112	113
S-24	Jar containing Example 3 resin in alkyd vehicle	107	112	113

	Description	Identified	Offered	Received
S-25	Jar containing Example 3 resin in acrylic vehicle	109	112	113
S-26	Jar containing Example 6 resin in alkyd vehicle	110	112	113
S-27	Jar containing Example 6 resin in acrylic vehicle	111	112	113
S-28	Jar containing Example 5 resin in alkyd vehicle	115	116	116
S-29	Jar containing Example 5 resin in acrylic vehicle	115	116	116
S-30	Batch chart No. 4683 of Radiant	187	190	190
S-31	Batch chart No. 4684 of Radiant	189	190	190
S-32	Batch chart No. 4833 of Radiant	190	190	190
S-33	Jar containing powdered Wayne resin R-7.	202	204	204
S-34	Jar containing Wayne resin R-7 in benzen prepared 9/20/65		203	203
S-35	Jar containing Wayne resin R-7 in toluen prepared 9/7/65		205	205
S-36	Jar containing Bennahmias resin R-16	206	207	207
S-37	Jar containing a 7-4-1 resin made by Bernahmias with 0.5 mole of urea		207	207
S-38	Kross affidavit	207	208	_
S-39	Table of quantitative solubilities of resins	213	301	302
S-40	Technical literature on benzene	221	223	223
S-41	Technical literature on organic solvents	223	224	226
S-42	Copies of pages from dictionary including definition of "insoluble"	_	230	231
S-43	Military specification	305		
S-44	Deposition of Daniel Bennahmias	325	_	_
S-45	Log sheet made during reaction of Benna mias resin R-16		457	457
S-46	Test tube containing S-37 resin in benzene.	471	480	480
S-47	Log sheet made during reaction of Benna mias resin R-16		613	613
S-48	Deposition of Dr. Huber	622	623	623



In the

United States Court of Appeals

For the Ninth Circuit

No. 20,944

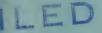
HARRY P. LOCKLIN AND ELMER J. BRANT, GENERAL PARTNERS DOING BUSINESS UNDER THE FIRM NAME OF RADIANT COLOR COMPANY,

Plaintiffs-Appellants,

vs.

SWITZER BROTHERS, INC.,

Defendant-Appellee.



APPELLEE'S BRIEF.

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United States Court of Appeals

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APPELLEE'S BRIEF.

COUNTER-STATEMENT OF THE CASE.

Radiant's "Statement of the Case" (ROB* 2) includes but fails to emphasize that this Court in its remand to the District Court (348 F. 2d 244, 246) directed:

"... that trial be had upon the sole question whether, in the 4-C resin, the amount of melamine utilized is such as to bring the resin within the limits of the claims of the Kazenas patent as those claims are delineated in our former opinion."

^{*} ROB is the abbreviation used herein to designate Radiant's Opening Brief on this appeal.

In so remanding, this Court specifically stated, also at page 246:

"The record does not, however, suggest that trial upon any other issue is similarly justified under the circumstances. In all other respects the order of the District Court is entitled to affirmance."

Such language clearly limits the scope of this Court's remand to "the sole question", and to that alone. Consequently, Radiant on this appeal is precluded from directly or indirectly attacking the validity and scope of the claims, held valid and infringed by this Court (299 F. 2d 160), as Radiant is here attempting to do on the specious ground that new evidence adduced in this Contempt proceeding now renders such claims indefinite and not in compliance with 35 U. S. C. 112.

Such new evidence, Radiant contends, shows that there is no "simple, clear test" for determining that sufficient melamine is present in the 4-C resin to render it substantially insoluble in aromatic hydrocarbon solvents. In so contending, Radiant directly flouts this Court's holding (299 F. 2d 160 at 166) that:

"There is testimony to the effect that 'sufficient melamine to render the resin substantially insoluble' is a simple, clear test for an ordinary chemist to perform and one which does not require extensive experimentation in order that the precise critical limits be ascertained in a particular case. Under such circumstances, the fact that some preliminary testing is required does not render the claim invalid for vagueness." (Emphasis supplied.)

The "simple, clear test" to which this Court had reference was the quick qualitative test, using toluene, that was independently adopted by both Radiant and Switzer, and used in the original trial, for evaluating the solubility or insolubility of the MSF resins in aromatic hydrocarbon

solvents. That test, as will be more fully explained later on in this brief, required only 24 hours, or, at most, less than a week to carry out. And it was on the basis of such test, using toluene as the exemplar of the "aromatic hydrocarbon solvents" of the claims, that this Court held the claims not invalid "for vagueness", or for "the use of functional language at the precise point of novelty".

But despite such final holding by this Court, Radiant seeks to show here that there is no "simple, clear test". It contends that the previously accepted quick qualitative test in toluene* is not the proper test, but that the evidence must show that the resin "remains" (in the sense of "continues to be") free flowing not only in toluene but also in benzene.

In so contending, Radiant is not only attempting to have this Court reverse its previous holdings based upon the toluene test as being "a simple, clear test" (which has now become "the law of the case") but also to have this Court reverse its ruling that: "The time for testing of proof is the time of trial" (299 F. 2d 160, 169).

Radiant, at the original trial, could have put in evidence that the toluene test is not adequate because of the shortness of time given for the test or because toluene is not exemplary of other aromatic hydrocarbon solvents, such as benzene. Not having offered such evidence as it could have produced at the original trial, Radiant should not now be permitted to introduce new (and clearly unreasonable) conditions into the quick qualitative test* that this Court found sufficient as "a simple, clear test" to support its holding that the claims are valid and free from vagueness or undue functionality.

On the basis of toluene being the proper aromatic hydrocarbon solvent for the quick qualitative test and a dura-

^{*} Which Radiant accepted and used at the trial.

tion for the test of 24 hours or, at most, less than one week, there is no dispute between the parties that all of the 7-4-1 resins (absent the urea of the accused pigment) here before this Court are substantially insoluble in aromatic hydrocarbon solvents. Therefore, on this same basis, the answer to "the sole question" is that: "in the 4-C resin, the amount of melamine utilized is such as to bring the resin within the limits of the claims of the Kazenas patent as those claims are delineated in our former opinion."

ONLY A SINGLE QUESTION IS PRESENTED ON THIS APPEAL.

Radiant's Question 1 (ROB 5) is the only question that Radiant can properly present on this appeal. It paraphrases "the sole question" presented by this Court's remand.

Radiant's Question 2 is not before this Court; it raises the issue of validity* of the claims in suit. This is res judicata no matter how adroitly Radiant may attempt to direct its question to whether there can be infringement by the accused pigments if such claims do not "truly comply" with Section 112.

This Court has already adjudicated the claims in suit to be valid. Such adjudication includes a ruling that the claims do "truly comply" with Section 112. The only question here in issue is whether the accused pigments and the 7-4-1 resins infringe the claims so adjudicated to be valid. As the Supreme Court held in Graver Mfg. Co. v. Linde Co., 339 U. S. 605, 607:

"If accused matter falls clearly within the claim, infringement is made out and that is the end of it."

^{*} Radiant admits that on the first appeal it attacked the validity of the Kazenas patent for claim indefiniteness (ROB 47-48). That was an attack for failure to comply with Sec. 112.

Switzer has already established in the first section of this brief that the accused pigments and the 4-C resins fall clearly within the claims adjudicated to be valid. The District Court on all of the evidence before it so found as a finding of fact (CT 115, 119).

Radiant's Specification of Errors Includes "Findings" Not Directed to the Sole Question on Remand.

The word "Findings" in the above caption is purposely placed in quotation marks so as to include not only findings that the District Court made but also "findings" which Radiant charges the District Court failed to make and as to which Radiant assigns error.

From this Court's language in remanding on "the sole question" and its statement that the order of the District Court should stand "in all other respects", this Court quite evidently did not intend the District Court on this remand to go into matters not directly related to "the sole question", and therefore not material to the answering of such question; nor did it intend the District Court to make findings that would disturb its previous findings (not related to the sole question), made in the District Court's Memorandum of Decision of March 31, 1964 (CT 91-102) on which the Order of April 16, 1964 (CT 103-105) was based.

On the assumption that this understanding is correct, we challenge the "errors" listed by number in Radiant's Specification of Errors (beginning at ROB 5):

Specification 1—This alleges as error failure of the lower Court to find that certain of Radiant's tests "proved that the accused pigment is not one that will remain free-flowing in either of the aromatic hydrocarbon solvents benzene or toluene".

Since Radiant has asserted that Radiant "proved that the accused pigments would remain free-flowing in both

benzene and toluene for more than two years" (ROB 38), how can Radiant now consistently assign error to the District Court's failure to find that Radiant's tests prove the contrary?

The accused pigment referred to as "the 4-C resin" in the District Court's first Memorandum of Decision (CT 91) was admitted by Radiant (CT 97) to be "substantially insoluble in aromatic hydrocarbons" and the District Court so found (CT 101). This Court has stated that such a finding should not be disturbed (348 F. 2d 244, 246).

Radiant's witness, Mr. Bennahmias, testified (RT 374-378) as to the samples of the accused 4-C, R 104, pigment made by him in 1963 (R-38, in benzene, and R-39, in toluene), that the pigment was free-flowing in *both* benzene and toluene when made and were still free-flowing at the time of the trial.

Yet Radiant asserts as error in Specification 1 the District Court's failure to find that "tests made with Radiant's inter partes test resin* produced on September 2, 1965 proved that the accused pigment is not one which will remain free flowing in either . . . benzene or toluene".

Is Radiant now taking the position that the test results on Wayne test resin R-7 prove that the accused 4-C pigment is *soluble* in aromatic hydrocarbon solvents, contrary to its admission (RT 356) and to the District Court's earlier finding (CT 101)? Or is Radiant discrediting the Bennahmias 1963 test results the same as the District Court did (CT 112) in the case of the 1963 Bennahmias test results on the JS-738 resin in benzene (R-43) and in toluene (R-44)?

This Court's attention is also invited to the further point

^{*}The particular "test resin produced on September 2, 1965", referred to in Specification 1 is not there identified but it is presumably "the Wayne test resin" (ROB 10-11), since Radiant states (ROB 14) that it is the "Wayne test resin R-7, upon which Radiant principally relies . . ."

that Specification 1 uses the word "remain" in the phrase "remain free flowing in either... benzene or toluene". As we shall more fully point out later herein, the term "remain" is satisfied by a lapse of time of 24 hours, or at most, a test period of less than a week; and toluene, not benzene, is the aromatic hydrocarbon that was used in the original trial to evaluate solubility or insolubility in aromatic hydrocarbon solvents, and therefore the toluene quick qualitative test has become the "law of the case".

Specifications 9, 10 and 11—These specifications assign error because the District Court failed to follow Radiant's unreasonable and unsupported contention* that in order to establish insolubility in aromatic hydrocarbons the resin must remain free flowing and unagglomerated in benzene for such prolonged periods as "seven weeks", or "at least as long as four months". The "benzene test" is either directly referred to or is implied by use of the term "aromatic hydrocarbon solvents" to include all such solvents, and therefore benzene. These alleged errors do not go to "the sole question" for the reason, just given, that the quick toluene test of 24 hours or less than one week is the law of the case and if that test is met, then the resin satisfies the "substantially insoluble" limitation in the claims as delineated by this Court in its 1961 opinion.

Specifications 2 to 6 and 8, inclusive—These alleged errors all relate to non-essential matters, such as choice of particular types or brands of melamine and/or sulfona-

^{*} Radiant's contention is not only unsupported, it is directly refuted by the testimony of its own witness, Mr. Bennahmias, that if Radiant's 24 or 48 hour test in benzene, toluene and xylene (RT 481-483) at 100° F. (RT 493) does not show agglomeration of the pigment, the pigment "has no defect" and "can be used in many systems in which they use aromatic hydrocarbon solvents . . ." (CT 114).

mides, or of particular process techniques. These are irrelevant matters in view of the District Court's earlier finding (CT 91-102, 97), that:

"Putting aside for the moment the question whether the new 4-C resin is completely condensed, the record does not disclose any factual dispute concerning the nearly identical relationship of the 4-C resin to the Kazenas claim. Radiant uses aldehyde, sulfonamide and melamine, the melamine being 18.45% by weight of the sulfonamide. The 4-C resins are thermoplastic. The three chemicals are present in the 4-C resin in proportions sufficient to render the condensation product substantially insoluble in aromatic hydrocarbons but insufficient to render it thermosetting. Radiant admits that the 4-C resin is, in fact, substantially insoluble in aromatic hydrocarbons." (Emphasis supplied.)

The Court quite properly made no distinction between one melamine or another melamine*, or between one sulfonamide or another sulfonamide; nor did it draw a distinction as to the specific process used in making the 4-C resin and the process set forth in method claim 9 in suit.

The product claims in suit (Claims 1 to 4) are not restricted to melamine or sulfonamide in terms that distinguish from the melamine and sulfonamide used by Radiant in the accused 4-C pigment or in any of the 7-4-1

^{*} Both buffered melamine and recrystallized melamine are melamine; there is nothing in the record to show that one had any different effect than the other on the resin made. Radiant's experts admitted they did not even know the pH of the reaction mass in Radiant's manufacture of the accused pigment (RT 451-453) so how could Radiant ascribe any importance to the difference in pH between its buffered melamine and Switzer's recrystallized melamine? Both had a basic, or alkaline, pH, not an acid pH as alleged in Specification 6. For, as Mr. Bennahmias testified (RT 433-434), the buffered melamine has a pH of about 8.1 and the unbuffered melamine has a pH of 7.2; both are on the alkaline side. And both "are of the same order of purity" (RT 644-645).

test resins here involved; nor is method claim 9 restricted to any special technique that might be employed, so long as the temperature used is one "up to 170° C." The temperature limitation is met by Radiant's use of temperatures, such as 163° C. (S-30; RT 189), that closely approximate the upper limit of temperature set forth in claim 9.

As to Radiant's contention (ROB 18) that by reason of the time-temperature conditions used by Mr. Gray "a different type of reaction occurred", this is fully rebutted by Dr. von Fischer's testimony (RT 646) that "we were basically at the same final temperature"; "the important temperature, of course, is the temperature of the mix".

With the exception of Radiant's Specifications 7, 12 to 14 and 23 to 25, which go directly and therefore properly to the sole question presented by the remand, none of the "Errors" alleged in the specifications, whether error in fact or not, is material to "the sole question" or in any way vitiates the ultimate holding of the District Court (CT 119):

"After a review of the entire record, as discussed in this opinion, the Court finds, in answer to the question presented here, that in the 4-C resin, the amount of melamine utilized is such as to bring the resin within the limits of the claims of the Kazenas patent as those claims are delineated in *Locklin v. Switzer Bros.*, *Inc.*, 299 F. 2d 160 (9th Cir. 1961)."

As to whether any of the Findings of Fact should be set aside by this Court notwithstanding Rule 52(a) F. R. C. P., this will be discussed under the appropriate heading later on in this brief.

ARGUMENT.

The Evidence and Radiant's Admissions Establish That the Accused Pigments Do Contain Sufficient Melamine (Absent Any Urea) to Answer This Court's Sole Question in the Affirmative.

Under its sub-heading "Preliminary Discussion of Evidence on the First Question" (ROB 8), Radiant quite frankly states that "each test resin used the three essential ingredients (melamine, sulfonamide and formaldehyde) of the patented resin but in the same 7-4-1 molar proportions as used in the manufacture of the accused pigment" (ROB 9).

In so stating, Radiant admits that in respect to the essential ingredients these test resins satisfy the claims in suit regardless of what specific melamine or sulfonamide is used.

The test resins also satisfy the claim limitation as to aromatic hydrocarbon solvent-insolubility on the basis (which we submit is the only correct basis) of the quick qualitative test in which toluene is used and the duration of the test is 24 hours or, at most, less than one week. Radiant actually admits by the testimony of its own witnesses that the test resins of the 7-4-1 formula, without urea, meet the quick qualitative test in toluene. It therefore follows that these test resins necessarily and inherently satisfy the limitation in the claims as delineated by this Court in posing "the sole question".

The testimony to which we refer is the following:

With respect to the Wayne test resin R-7, "upon which Radiant principally relies" (ROB 14), Bennahmias testi-

fied, on the basis of the condition of the R-7 resin in toluene (R-9), that the Wayne test resin was "free flowing in toluene at the time of the trial" (RT 386), viz., some five or six weeks after the Wayne test resin was made on September 2, 1965.

With respect to the Bennahmias test resin R-16 (also designated as JS-738, CT 112), Bennahmias testified that at the time of the trial the R-16 resin in toluene (R-18) became "free flowing" when subjected to eight hard shakes (RT 418; ROB 19). This admission provided the basis for the District Court's finding (CT 113) that the condition of R-18 showed the Bennahmias test resin (R-16 or JS-738) to be free flowing in toluene. The District Court also found that the Bennahmias resin in xylene (R-19) was free flowing at the time of the trial (CT 113).

Thus the admissions made by Radiant's own witnesses as to the free flowing condition in toluene of both the Wayne and the Bennahmias test resins clearly establish that those 7-4-1 resins, without urea, meet the requirements of the claims as delineated by this Court. Since the 7-4-1 resins are admittedly identical, as to the essential ingredients, melamine, sulfonamide and formaldehyde, to the accused pigment but contain no urea, it follows from such admissions that, as found by the District Court, both the "accused 4-C resin" (meaning the accused pigment) and "the 4-C resin" (e.g., the 7-4-1 test resins) utilize sufficient melamine (by itself) to render each of them insoluble in aromatic hydrocarbon solvents (CT 117, 119). Quod erat demonstrandum.

The Gray test resin (S-5), a 7-4-1 resin (with no urea), was found by the District Court (CT 112) to have "remained free flowing and dispersed 24 hours after being placed in the pure solvents. Switzer also demonstrated at the trial that the [S-5] resin placed in the solvents on September 25, 1965, which had stood unshaken for 17 days,

was free-flowing upon being shaken at the trial." The "pure solvents" referred to by the Court were benzene, toluene and xylene.

Radiant's only complaint as to the 7-4-1 Gray test resin was as to insignificant differences in its manufacture as compared with the manufacture of the accused 4-C resin by Radiant. As to such differences, the District Court stated (CT 115):

"The Court finds no merit in Radiant's contention that the results are not reliable because of certain differences between the kind of melamine* Switzer used in its qualitative tests and that used by Radiant, and because of certain differences in the method of preparation of the test resin by Switzer."

As to the Gray test being a laboratory experiment, so was the Bennahmias test a laboratory experiment (ROB 11). And as to the time-temperature relationship used by Mr. Gray, Dr. von Fischer (RT 646) fully rebutted Radiant's contention that "a different type of reaction occurred". (ROB 18)

The District Court's finding that there was "no merit in Radiant's contention" was fully justified by the evidence and should not be disturbed.

The District Court Correctly Found That a Lapse of Time of Less Than a Week Was Sufficient for Evaluating Insolubility by the Quick Qualitative Test.

As is apparent from a reading of the excerpts (quoted at ROB 23-24) from the District Court's Memorandum of Decision (CT 111-113), the District Court recognized that

^{*} As to the melamine used in making the Gray test resin (S-5), Radiant's expert, Dr. Huber, admitted, with reference to the Chart of claim 2 of the patent (R-59), that "there is nothing on this illustrative chart that requires any particular melamine" (RT 618).

there was "a dispute over how long the resin must remain without coalescence or agglomeration to come within the defining words of the patent claim: 'substantially insoluble in aromatic hydrocarbon solvents'." But the Trial Court then proceeded to make as a finding of fact that "... the 24 hour and 17 day qualitative tests conducted by Switzer... are simple clear reliable tests, which demonstrate that, in fact the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 115). (Emphasis supplied).

Where there is a dispute as to what the evidence shows, the trier of the facts is in the best position, because of its "opportunity to judge of the credibility of the witnesses", to decide which disputant's evidence is entitled to the greater weight, and its decision should not be lightly overruled (F. R. C. P. 52(a)). The primary issue here is a fact issue. It is not a legal issue, as Radiant contends, for the simple reason that this Court had already delineated "the limits of the claims" in its former opinion; it remanded to the District Court "the sole question" for a fact finding, and that only.

Radiant contends (ROB 28) that this Court's use of the word "remains" in the clause "which remains insoluble without agglomeration in aromatic hydrocarbon solvents" is used in the dictionary sense, "to continue unchanged ...", and thus "is not limited by time".

Such a contention leads to a "reductio ad absurdum" situation. As Dr. von Fischer stated in answer to a question on cross (but only in the context of the question), the resin would have to stand in a suspended condition "forever" (RT 256). Surely this Court did not mean the resins must "remain insoluble" [forever] "without agglomeration in aromatic hydrocarbon solvents". (Bracketed word supplied).

Sush an interpretation of this Court's language would mean that no quick qualitative test could be used for evaluating insolubility. Yet both the original Trial Court and this Court, in holding the patent claims valid and infringed, implicitly relied upon the 24-hour or the less than one week tests in toluene, such as were made on the patented resins by Radiant and were put in evidence in the original trial. The "less than one week" test in toluene was accepted by the District Court on the basis of its adoption at the original trial (CT 112).

Judge Goodman's refusal (OR 135) to accept tests of Radiant's expert, Mr. Paulsen, was because of the manner in which he carried out some of the methods of the Patent Examples. There is no justification whatsoever for Radiant saying (ROB 29) that "Judge Goodman expressly rejected as being 'not reliable' the only solubility tests based on a one week observation". The term "a one week observation" is not even used or implied in Judge Goodman's holding that: "The experiments performed by Plaintiff's expert... are not reliable evidence..." (OR 135).

This misrepresentation of what Judge Goodman ruled is inexcusable.

So is Radiant's conclusion (ROB 29) that the District Court and Switzer "have disowned Dr. Hatcher's tests and testimony". Such tests were as to Dr. Hatcher's resin sample of Example 5 of the patent. The tests showed that this resin sample was still free-flowing in toluene upon examination at the trial four months after the date when made. Judge Goodman, in accepting this sample as being within the claims in suit, because insoluble in aromatic hydrocarbon solvents, did not require any particular length of time for evaluating either that or other resins of the patent, nor did he even comment thereon; but he did accept the testimony of Radiant's expert, Mr. Paulsen, that samples of the resins of Examples 1, 3 and 6 of the

patent, which were tested in toluene after a lapse of time of less than a week, were insoluble (OR 278-279).

Although admitted by Radiant at the original trial to be insoluble in aromatic hydrocarbon solvents, these same resins of Examples 1, 3 and 6 (S-19, S-18 and S-20, respectively) at the time of the evidentiary hearing on Contempt were in a plugged or caked condition in toluene (RT 88-94)! This one fact makes it clearly obvious that the lapse of time required for the qualitative test in evaluating resins for substantial insolubility cannot be "forever", nor should this Court's use of the term "remain" be construed in the dictionary sense of "to continue unchanged", without any limit as to time.

Whenever a pigment is suspended in a liquid vehicle it tends to settle out on standing, e.g., a paint pigment in an oil vehicle. The suspended pigment ultimately settles and packs or cakes at the bottom of the container. It does not "continue unchanged". The Mil Spec. (S-43 for identification) clearly recognizes such tendency of resin pigments to settle, even to the extent of requiring a paddle to redisperse them. (cf. p. 4, 3.7.1) Even resins that had stood in toluene for less than a week and that Mr. Paulsen testified were insoluble in aromatic hydrocarbon solvents settled out but could be redispersed by shaking or by the use of a spatula (OR 277-279).

In contrast, the admittedly soluble Japanese resin (S-15) almost immediately started to lump and was not redispersible upon being placed in toluene (S-17) in the Court demonstration carried out by Mr. Gray (RT 78-83). Mr. Gray had never seen a 7-4-1 resin that had as quick a coalescence as observed in this court demonstration of the Japanese resin (RT-185).

In view of this court demonstration, it must be clearly evident that all of the 7-4-1 resins have a much greater

degree of insolubility in toluene than the closest prior art resin, viz., that of the Japanese patent. The use of the phrase "remain free flowing" takes on real significance by virtue of this vast difference between the Japanese resin and the 7-4-1 resins in point of time required for agglomeration or coalescense when subjected to the quick qualitative test in toluene. The adoption by the District Court of the 24 hour or less than a week test period is not only justified because it has become the law of the case, but because it places a reasonable finite time limit upon the word "remain" or "remains" as used in the decision of this Court (299 F. 2d 160, 162-163).

Switzer agrees that both it and Radiant alike are now bound by this Court's earlier decision (ROB 29). It is Radiant that wrongly urges its freedom to contest such earlier adjudication, not Switzer.

Switzer did not induce this Court to hold the claims valid on the basis of any different insolubility test than the toluene quick qualitative test that Switzer has used in this Contempt proceeding. The District Court adopted such test in its findings.

There were no "insolubility tests lasting more than four months" on the basis of which Switzer induced this Court to hold the claims valid. As this Court said in its decision (299 F. 2d 160, 169) with respect to the Hatcher test, carried out on a resin sample identified as Dx N (ROB 27):

"If the fact was that the resin would agglomerate and would not remain free flowing, Radiant could have established this by its own pre-trial experiments and have introduced evidence with respect to those experiments at the proper time."

This admonition, clear from the above quoted ruling of this Court, is equally applicable to evidentiary matter that Radiant now seeks to rely upon and that it could have brought into the original trial on the issues of infringement and validity.

The very voluminous record of the original action. C. A. 36,995, will reveal that Radiant brought numerous motions (several amounting to motions for a new trial on the basis of allegedly "new evidence"). All such motions were denied. Radiant mentions only one such motion* (ROB 27). The decisions denying those motions, affirmed by this Court (299 F. 2d 160, 169), constitute a further bar against Radiant's right to use here the same or other "evidence" on the same issue that it could have introduced into the original trial. None of the evidence as to the sufficiency of the toluene quick qualitative test for evaluating insolubility of resins in aromatic hydrocarbons, here used by Switzer to establish the answer to the present issue of whether the 4-C resin utilizes sufficient melamine etc., is evidence that Radiant could not have introduced in the original trial on the issue of the validity and scope of the claims in suit.

The District Court Properly Included Benzene; The 24-Hour Qualitative Test Showed the 7-4-1 Resins To Be Insoluble in Benzene.

Radiant's statement in its heading "The District Court erred in defining aromatic hydrocarbon solvents" (ROB 20) is palpably untrue. The very finding of the District Court that Radiant quotes in support of such alleged error shows that the District Court properly included benzene in the term "aromatic hydrocarbon solvents" for such finding

^{*} This was a Motion for New Trial (OR 211-219) in which Radiant charged Switzer with misrepresentation as to the Kazenas resin being substantially insoluble in aromatic hydrocarbons because of Switzer's "failure to produce any examples of Kazenas resin suspended in benzene, which plaintiffs now believe to be a stronger aromatic hydrocarbon solvent than the toluene solvent used by the parties at the trial . . ." (OR 215).

names benzene as "the strongest of the three aromatic hydrocarbon solvents."

The District Court justifiably adopted toluene, rather than benzene, as the solvent to be used in the quick qualitative test, since toluene was the aromatic solvent used in the original trial in the qualitative test that this Court termed "a simple, clear test" for evaluating the "substantial insolubility in aromatic hydrocarbon solvents" of the patented resin.

The District Court could just as well, however, have based its finding of aromatic hydrocarbon insolubility on the 24 hour qualitative test using benzene, since the Gray test resin and the Wayne test resin, both of them 7-4-1 resins, were dispersible in benzene for at least 24 hours and were therefore insoluble in benzene, in addition to toluene and xylene, on the basis of the 24 hour quick qualitative test.

As to the Switzer-made 7-4-1 resin (S-5), that resin in benzene (S-6) was still free flowing at the time of the trial, 17 days or so after it was made on September 25, 1965 (RT 194-195; 201). The same resin (S-5) at the time of the trial was also free flowing in toluene (S-7) and in xylene (S-8) (RT 201-202).

As to the Radiant-made Wayne test resin (R-7), this also was a 7-4-1 resin, but made in the inter partes test on September 2, 1965 (RT 202) and offered by Switzer as S-33. Dr. von Fischer testified that from September 20, 1965, when this resin (S-33) was placed in benzene (S-34), until October 12, 1965, a date during the evidentiary hearing, the resin was found to be dispersible at each daily inspection on slight shaking. From this Dr. von Fischer concluded, based upon this qualitative test, that the resin (S-33), or (R-7), is insoluble in benzene (RT 203). The same resin (S-33) when dispersed in toluene

(S-35) was also dispersible and therefore insoluble in toluene. No test was made in xylene since Dr. von Fischer believed it would certainly be dispersible in xylene if it were in both toluene and benzene (RT 205-206).

Since the Wayne test resin (R-7) was the resin "upon which Radiant principally relies" (ROB 14), the uncontested finding by Dr. von Fischer that the R-7 resin was insoluble in benzene should be sufficient proof that the 7-4-1 resin is insoluble in benzene, as well as in toluene and xylene on the basis of a 24 hour qualitative test.

Radiant's attempt to discredit the 24 hour qualitative test should be rejected, just as the District Court did and for the same reasons (CT 113-114).

Switzer is not attempting to reconstrue the term "aromatic hydrocarbon solvents" so as to eliminate benzene (ROB 22); it submits, however, that the limitation in the claims is satisfied by the use of toluene as the exemplar of "aromatic hydrocarbon solvents" in the quick qualitative test that became the "simple, clear test" referred to by this Court in affirming Judge Goodman's adjudication of validity (299 F. 2d 160). Switzer agrees with Radiant that the claims in suit "must now be construed on the contempt hearings in a manner consistent with their validity" (ROB 23); Switzer, however, submits that this is being done by giving effect to the toluene test as the "law of the case".

Radiant argues (ROB 22-23) that the claims of the patent in suit require that the insolubility of the resin be tested in all aromatic hydrocarbon solvents, citing Corona Co. v. Dovan Corp. (1928), 276 U. S. 358 and Graver Mfg. Co. v. Linde Co. (1949), 336 U. S. 271. The facts of these two cases make them clearly inapplicable to the fact situation presented here. In Corona, the patent claimed certain broadly defined guanadine derivatives for use as accelerators for the vulcanization of rubber. In Graver, the patent

claimed welding fluxes comprising certain broadly defined silicates as ingredients. In both cases the broadly defined compounds were the crucial components of the composition that was claimed to be novel.

In contrast, the aromatic hydrocarbon solvents here referred to are not named as components of the claimed resin composition. The claims are directed to the resin, per se, or to the method of making the resin. Aromatic hydrocarbon solvents are mentioned in the claims in suit only in connection with a test which serves to identify those resins that include a sufficient amount of melamine to impart to the resins desired insolubility charactertistics.

On the basis of the testimony of credible experts in the original trial and in the evidentiary examination, the toluene test was held sufficient to establish the substantial insolubility of the MSF resins in aromatic hydrocarbon solvents.

Such holding should not be disturbed for the same reasons as this Court deemed sufficient in *Research Products Co., Ltd. et al.* v. *Tretolite Co. et al.* (9 Cir. 1939), 106 F. 2d 530, 534:

"We conclude that the finding of the court and special master as to the meaning of the patent is sustained by the testimony of credible experts appearing before the special master and that the finding should not be disturbed insofar as it is drawn in question here. If it is indefinite in some respects due to the comprehensive character of the invention and of the claims therefor, it is not uncertain in the area of description involved in this action. Any vagueness in those outlying boundaries of the description does not invalidate the patent as to that which is clearly defined. Carnegie Steel Co. v. Cambria Iron Co., 185 U. S. 403, 22 S. Ct. 698, 46 L. Ed. 968; Faultless Rubber Co. v. Star Rubber Co., 6 Cir., 202 F. 927."

The Trial Court found the toluene test to distinguish the claimed resins patentably from the prior art resins, such as the resin (S-15) of the Japanese patent.

Inasmuch as the 7-4-1 resins have also been shown by credible witnesses to be insoluble by the 24 hour qualitative test using benzene, Radiant's contention (ROB 23), that its specifications of error 9 and 10 should be sustained, should be rejected. There is no matter of law here involved but only a fact issue, and that has been decided by the District Court.

The Trial Court Properly Considered the Quantitative Test Results Along With the Quick Qualitative Test Results.

In contending that the District Court erred in considering quantitative tests of solubility (ROB 33 et seq.), Radiant uses a sledge-hammer in its attempt to kill a gnat. Before even considering the quantitative test results, and therefore solely on the basis of the results of all of the qualitative tests, the District Court held (CT 115-116) as follows:

"The Court, however, in no wise suggests that the above tests represent the minimum standard for determining the question presented or that the 24 hour qualitative test, alone, would not suffice for determining the question here. The Court merely holds that the above tests when considered together do in fact show beyond any doubt that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (Emphasis supplied.)

The District Court then proceeded to make its findings with regard to the 24 hour quantitative test (CT 116):

"In addition to the above qualitative tests made by Switzer, Switzer also made a 24 hour quantitative test. In this test a carefully measured portion (.10 grams) of the JS-738 resin (which was a sample resin made by Radiant but without any urea) was deposited in 50 milliliters of each of the three pure solvents. In addition, a carefully measured portion of the JS-739 resin (also a sample made by Radiant but containing a half-mole of urea) was deposited in 50 milliliters of

each of the three pure solvents.

"After allowing all of these solutions to stand for 24 hours, Switzer determined how much of the resin had gone into solution, i.e., the solubility. Switzer determined that in benzene, .020 grams of the JS-738 resin had dissolved per 100 milliliters of benzene, while .010 grams of the JS-739 resin had dissolved per 100 milliliters of benzene. In toluene, Switzer determined that .007 grams of the JS-738 resin had dissolved per 100 milliliters of toluene, while .002 grams of the JS-739 resin had dissolved per 100 milliliters of toluene. In xylene, Switzer determined that .003 grams of the JS-738 resin had dissolved per 100 milliliters of xylene, while .002 grams of the JS-739 resin had dissolved per 100 milliliters of xylene, while .002 grams of the JS-739 resin had dissolved per 100 milliliters of xylene."

The first above quoted holding, which is based solely on the qualitative test results, is a finding of fact that fully answers the sole fact question put to the District Court on the remand. The District Court could have stopped at this point, since it had found the ultimate fact that this Court left for the District Court's determination. Such finding should be allowed to stand. Rule 52(a).

Based upon the just recited quantitative test results, however, the District Court further found (CT 117):

"... the results of the quantitative tests with the JS-738 resin *substantiate* the findings of this Court with regard to the qualitative tests, to wit: that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents." (Emphasis supplied.)

Switzer respectfully submits that the finding "beyond any doubt" (CT 115) of the ultimate fact, based as it was upon the qualitative test results, required no substantia-

tion by the quantitative tests. That being so, Switzer prefers not to burden this Court with an extended and probably unnecessary answer to Radiant's intricate and unconvincing arguments as to why the quantitative results should not be given credence.

In declining to answer Radiant in extenso on this matter of the quantitative tests, Switzer respectfully points, however, to the following evidence that the 24 hour quantitative test is a proper length of time for the test and that the 24 hour quantitative test establishes insolubility of the 7-4-1 resins in toluene:

- (1) The 24 hour test had its origin in the selection of 24 hours by Radiant's affiant, Dr. Robert D. Kross, S-38, in his quantitative solubility tests on various MSF resins. In Dr. Kross' Affidavit (S-38, at p. 4) he specifically pointed out that containers of the resin and solvent, used in his quantitative solubility tests, "were allowed to remain for 24 hours at ambient temperatures, to assure the full attainment of equilibrium." (Emphasis supplied);
- (2) In a pre-trial discovery deposition of Radiant's expert, Dr. Huber (S-48), Dr. Huber was asked (RT 623) the following question and gave the following answer:
 - Q. "Now, if a substance were soluble to less than a tenth of a percent would that be substantially insoluble?

A. "Yes".

- (3) Dr. von Fischer's tabulation of Quantitative Solubility Measurements (S-39) shows much less than 0.1% solubility (approximately equivalent to 0.1 grams of resin in 100 ml. of solvent) for all the resins, S-5, S-33, S-36 and S-37, even in benzene, and between 0.002 and 0.007% solubility in toluene;
- (4) Dr. Weiner, one of Radiant's experts, by his chart of the Quantitative Solubilities of Resins (R-48), showed

that of the three inter partes test resins, R-16, S-5 and R-7 resins, the R-16 resin (also called the Bennahmias JS-738 resin) evidenced the highest degree of solubility (in a 24-hour test, standing at room temperature in toluene), to wit, 0.014 grams/100 ml. of toluene. This same chart gives the solubility of the resin of Example 5 of the patent as 0.041 grams/100 ml. of toluene, almost three times the solubility figure of 0.014 for the R-16 resin. Since the patent Example 5 resin was found by Judge Goodman (OR 138) to be substantially insoluble in aromatic hydrocarbons, certainly the three times more insoluble Bennahmias test resin R-16 should also be held insoluble on the basis of Dr. Weiner's own quantitative tests, all carried out under identical conditions.

- (5) The same Weiner chart (R-48) shows the Japanese resin (S-15) to have a solubility 0.180 grams/100 ml. of toluene. This means that the Japanese resin was found by Dr. Weiner to be thirty-six (36) times more soluble in toluene than the Gray test resin (S-5), for which Dr. Weiner's figure is 0.005.
- (6) Dr. von Fischer testified (RT 237-238; 313-316) based upon his knowledge and experience that since the 7-4-1 resins here in evidence all met the qualitative and quantitative tests (meaning the 24-hour tests), they would be satisfactory for use as pigments in common paint vehicles* and would not coalesce on standing, and would

^{*} The patent in suit supports a distinction in degree between the insolubility of the Kazenas resin in "many common vehicles" (e.g., paint vehicles) "without coalescence or agglomeration" (column 1, lines 57 to 60), and the "practically insoluble" characteristic of the pigments of such resins "in aromatic hydrocarbon solvents" (column 6, lines 4 to 8). (Emphasis supplied) As the District Court found (CT 114): "Pure hydrocarbon solvents are never used alone with resin in a paint vehicle, but only in conjunction with other liquids and substances which in effect reduce the strength of the pure solvent."

meet the requirement in that respect of Mil. Spec. (S-43 id);

(7) The dictionary definition of "insoluble" (S-42) is: "not dissolving except in very minute quantities."

With the foregoing evidence before it, the District Court held (CT 116-117) that:

"It appears, therefore, that in the 24 hour period only very minute quantities of the JS-738 resin and of the JS-739 resin went into solution. Although these quantitative tests were not before the Court in the original infringement trial in 1959, the Court finds that the results of the quantitative tests with the JS-738 resin substantiate the findings of this Court with regard to the qualitative tests, to wit: that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents."

Urea Is Not Responsible for the Insolubility of the Accused Pigments; Melamine Is.

Although seeming to agree with the District Court that the question of whether urea produced substantial insolubility of the accused pigments "is not the determinative issue" (ROB 36), Radiant nevertheless attempts by obscure reasoning to find support for its contention that the District Court erred in its findings to which Specifications 21 and 22 are directed, viz., to this same non-determinative issue.

The District Court quite correctly said that this issue "is not the determinative issue referred to this Court by the Court of Appeals" (CT 117-118). It said this, however, after making its finding of fact "that the accused 4-C resin contains sufficient melamine to render it substantially insoluble in aromatic hydrocarbon solvents" (CT 117). That was the determinative issue. What the District Court held as to this non-determinative issue may be superfluous, but is nevertheless directly supported by the evidence to

which the District Court referred in making the allegedly erroneous findings.

Before considering Radiant's feeble attempt to distort the effect of such evidence, let us first consider the following admission made by Radiant's expert, Mr. Bennahmias (CT 446):

"According to my experience, I am positive that you could make a resin of the 7-4-1 proportions and obtain substantially (sic) insolubility in aromatic hydrocarbon solvents." (RT 446)

We submit that this categorical statement is binding upon Radiant as an admission that a 7-4-1 MSF resin (without urea) can be made that is substantially insoluble in aromatic hydrocarbon solvents. If such a 7-4-1 resin can be made, then certainly it would have to be the melamine that is responsible for the insolubility of the resin; it could not be urea, because the question that Mr. Bennahmias was answering was limited to "the three essential ingredients, melamine, sulfonamide and formaldehyde . . . in the 7-4-1 proportions." (RT 445.)

With that as a background, it should not have been surprising to Radiant that the Gray test resin S-5, a 7-4-1 resin without urea, met all the tests for substantial insolubility in aromatic hydrocarbon solvents, not only the toluene sample (S-7) and the xylene sample (S-8), but also the benzene sample (S-6) (RT 194-202). All of these samples remained free-flowing when the containers were inverted and shaken at the trial (RT 201-202). The clapsed 17 days (between making and shaking these samples at the trial) is a longer period of time than the maximum one-week period deemed sufficient by Radiant (OR 278-279) in the original trial for Radiant to establish insolubility in toluene (and therefore in aromatic hydrocarbon solvents) of the resins of Examples 1, 3 and 6 of the patent (here in evidence as S-19, S-18 and S-20, respectively.)

Radiant (purposely, we submit) makes no reference whatsoever in its Brief to the above evidence as supporting the Court's findings (CT 117-118). Instead, Radiant makes the unsupported, but at the same time unequivocal, statement that "the only meaningful evidence in the case shows conclusively that the urea used in the manufacture of the accused pigments contributes substantially to the insolubility of the resin" (ROB 36).

Such "evidence" as Radiant refers to (ROB 37-39) is far from conclusive.

Radiant's showing at the time of the evidentiary hearing in this Contempt proceeding was that the JS-738 resin (a 7-4-1 resin without urea, identified also as R-16) "had agglomerated in benzene after seven weeks (Pex R-17; RT 417)."

However, as to this same Bennahmias test resin R-16, Bennahmias testified (RT 445) that he did not know for sure whether he observed the sample in benzene (R-17) after the first day, so he could not say whether it was dispersible in benzene for 24 hours or not.

This Court is fully justified, therefore, in disregarding Radiant's arguments as to the benzene insolubility of the 7-4-1 resins based upon the agglomeration of the R-16 (or JS-738) resin in benzene after a lapse of 7 weeks (ROB 37).

Nevertheless, on the basis of Radiant's evidence as to the agglomeration in benzene of the JS-738 resin, made without urea, Radiant draws the *non-sequitur* conclusion that "it thus became completely unnecessary and irrelevant for Radiant to show the effect of urea in making the accused pigment" (ROB 37).

Switzer, however, supplied the evidence as to the *lack* of effect of urea by introducing Radiant's own test of the JS-739 resin made by Mr. Bennahmias at the September 3, 1965 *inter partes* test. Upon Radiant's failure to offer

this JS-739 resin in evidence, Switzer offered it as Switzer Exhibit, S-37. This was a 7-4-1-0.5 resin, viz., a 7-4-1 resin with half a mole of urea added. The District Court's own examination of the condition of the JS-739 resin in benzene (S-46) confirmed Mr. Bennahmias' admission (RT-472-473) that this urea-containing resin agglomerated in benzene: "... this JS-739 (with urea) was in the same agglomerated condition as the JS-738 resin (without urea), and Mr. Bennahmias so admitted" (CT 118).

Radiant weakly maintains that this agglomeration of the urea-containing resin in benzene "does not demonstrate that the urea had no effect on the solubility of 7-4-1 resins" (ROB 37). The District Court held otherwise, but offered alternative conclusions in so holding (CT 119):

"Our conclusion is that (1) either Radiant's contention that its '4-C resins are rendered subtantially insoluble in aromatic hydrocarbon solvents by using urea in addition to melamine' is wrong or (2) the benzene tests which showed that after seven weeks the JS-738 resin (without urea) and the JS-739 resin (with urea) had agglomerated do not disprove that either resin is substantially insoluble in aromatic hydrocarbon solvents."

In complaining (ROB 37) that "it is anomalous" that the Court should "use benzene tests as a basis for evaluating the comparative solubilities of the JS-738 and JS-739 resins", Radiant completely disregards what the Court said in the second part (2) of its above quoted conclusion. A seven-week duration for the benzene tests is wholly too long. For any quick test to be useful, it must really be quick, not one that requires seven weeks, four months or something approaching eternity as Radiant wants the word "remain" to be construed.

The District Court's conclusion as quoted above is the only correct one to be drawn. It should be affirmed as a fact finding of the Trial Court (F.R.C.P. 52(a)).

That rule is particularly applicable to this finding since the Court's rejection of the evidence as to the 1963 Bennahmias resins JS-738 and JS-739 (on which Radiant seeks to rely, ROB 37) was because the tests on those resins "were not conducted under the observation of Switzer" (CT 113). If this reflects upon the credibility of Radiant's witness, Mr. Bennahmias, the "due regard" clause of Rule 52(a) should be given effect in evaluating all test results on resins made by Bennahmias in 1963. These include the tests in benzene and toluene of the R-38 and R-39 resins (both said to be 4-C pigments prepared by Bennahmias on or around July 2, 1963) and referred to by Radiant (ROB 38-39).

Actually, as to the JS-738 and JS-739 resins, made by Mr. Bennahmias in 1963, his own testimony (RT 407-408; 516-517) shows that neither of these resins agglomerated in toluene (R-44 and R-47) within 24 hours or within a period less than one week. So both of these resins, the 7-4-1 resin (without urea), and the 7-4-1-0.5 resin (with 0.5 moles of urea) passed the toluene quick qualitative test that we submit is the law of the case. That the JS-739 resin (with urea) "remained free flowing" longer than the JS-738 resin (wthout urea) is of no real significance here, since both resins met the toluene test approved by the Court.

What Radiant contends or does not contend as to whether the JS-738 or the JS-739 is usable as a substitute for Radiant's 4-C resin (ROB 39) is beside the issue here. Radiant has not established that the half-mole of urea in the accused pigments is necessary to render such pigments "substantially insoluble" within the delineation of that term by this Court. The melamine content, by itself and without any added urea, has been established to be sufficient for that purpose.

This was the "sole question" before the Trial Court on

remand by this Court. The District Court has restricted its Memorandum of Decision (CT 107) to this sole question and has answered it in the affirmative. Its findings of fact are not "clearly erroneous"; the Trial Court had "the opportunity to judge of the credibility of the witnesses"; and "its findings should not be set aside." F. R. C. P. 52(a).

Rule 52(a) Does Control the Issue on This Appeal.

Under its heading contrary to the above, (ROB 12), Radiant cites several cases in support of its contention that "the issues presented on this Contempt appeal do not depend so much upon credibility of witnesses as they do upon the construction of the Kazenas patent claims and the earlier decision of this Court".

Switzer takes exception to this quoted contention. The credibility of the witnesses is a factor, since Radiant's criticism of much of Switzer's evidence, e. g., as to the Gray test resin, was quite evidently rejected by the District Court after judging of the credibility of the testimony of Radiant's witnesses as against the credibility of Switzer's witnesses. The District Court must also have judged of the relative credibility of witnesses in rejecting the testimony of Mr. Bennahmias and accepting the testimony of Dr. von Fischer on disputed points.

As to the construction of the Kazenas patent claims, the construction that controls here is that already placed on the claims by the 1961 decision of this Court. There was left, therefore, only factual findings for the District Court to make on the remand to it of "the sole question".

The *Union Carbide* v. *Graver* case 196 F. 2d 103, (ROB 13) is inapposite here. Here, the difference between the patented composition of Switzer's and Radiant's accused composition is the same difference that distinguished the

patented resin from the resins of the prior art. Switzer is not now endeavoring to enlarge the scope of the patent claims to include the accused 4-C resins as an infringement; the same limitation in the claims that distinguishes the patented resins from the prior art resins, including the Japanese resin, is the limitation that the District Court found to be met by the accused pigments and by the 7-4-1 resins. Switzer is in no way seeking to enlarge the claims in suit beyond the delineation given them by this Court when it adjudicated the original accused Radiant pigments to be in infringement (299 F. 2d 160).

The limitation, "substantially insoluble in aromatic hydrocarbon solvents", is here supported by the same quick qualitative test that distinguished the adjudicated resins, and now distinguishes the accused pigments and the 7-4-1 resins, from the prior art Japanese resin.

The finding of the District Court that the 7-4-1 resins utilize sufficient melamine by itself to render such resins substantially insoluble in aromatic hydrocarbon solvents is not a legal but a factual finding based upon the same quick qualitative test that this Court surely had in mind when referring in its former decision to a "simple, clear test".

Furthermore, in the cited case, the 7th Circuit Court of Appeals reached the decision that it did on the basis that the legal issues of the doctrine of equivalency and also of estoppel were there involved. This Court (348 F. 2d 244, 246) rejected the doctrine of equivalency that Switzer previously urged as justifying a decision that the accused pigments infringed the patent in suit. Here, "the sole question" is purely and simply a factual issue.

In the *U. S.* v. *Parke*, *Davis* case (362 U. S. 29) which was an anti-trust case, the Court held that Rule 52 did not require "affirmance of the District Court's ultimate

finding that respondent did not violate the Sherman Act because that conclusion was based on an erroneous interpretation of the standard to be applied.

Here, this Court provided the standard to be applied, viz., the "simple, clear test" that had been used in the original trial to evaluate the substantial insolubility of MSF resins in aromatic hydrocarbon solvents. The District Court applied such standard to the factual evidence before it, evaluated the conflicting testimony of the "live" witnesses and made its fact findings accordingly.

It is these fact findings that Switzer submits are protected by Rule 52(a). They are not "clearly erroneous" and they are based upon the testimony of "live" witnesses.

In *U. S.* v. *General Motors*, cited by Radiant as appearing in 16 L. Ed. 2d 415, now reported in 86 S. Ct. 1321 (1966), the Supreme Court referred to and followed its previous *Parke*, *Davis* decision (362 U. S. 29, 44-45). Before the portion quoted by Radiant (ROB 13), the Supreme Court pointed out that the rationale behind Rule 52(a) plays only a restricted role where the case "did not unfold by the testimony of 'live' witnesses."

Here the case did unfold by the testimony of "live" witnesses. Furthermore, contrary to the showing in the cited case, Radiant is asking that this Court "contradict the Trial Court's findings of fact, as distinguished from its conclusionary 'findings'." (86 S. Ct. 1321, 1329 fn 16).

In view of the foregoing distinctions from the grounds upon which the Supreme Court rested its decisions in the cited case, Switzer respectfully submits that Rule 52(a) should here be given full effect and the fact findings of the District Court affirmed.

Summary of Switzer's Position as to Radiant's Questions 1 and 2.

- (1) Had the "sole question" been a question of law, this Court would not have remanded; it would have decided the question itself. By its "delineation" of the scope of the limitation in the claims in suit, this Court eliminated any legal question from what it instructed the District Court to determine on remand. Consequently, the fact findings of the District Court should not be disturbed.
- (2) Radiant should not be permitted to raise for the first time on this appeal the issue involved in its Question 2 of the alleged invalidity of the claims for non-compliance with Section 112 of the Patent Statutes. That issue was not raised by Radiant in the evidentiary hearing or in Respondent's Post Trial Memorandum of Points and Authorities Relative to Facts of Case, filed by Radiant following the evidentiary hearing. The District Court had no occasion to and did not pass upon the issue raised by Question 2.

RADIANT'S QUESTION 2.

At this late date, Radiant attempts to present a second question to this Court challenging the validity of the Kazenas patent on the basis of non-compliance with U. S. C. Title 35, Section 112. On the basis of the same record as here and using the same arguments that Radiant used in its unsuccessful Motion for Leave to File Second Petition for Rehearing in March, 1966, Radiant again seeks to have this Court reverse its Judgment of November 16, 1961 affirming the validity of the patent in suit. Radiant's Motion was denied by this Court, without opinion, on April 20, 1966.

Radiant now attempts to inject the same arguments obliquely into this Appeal notwithstanding the fact that

a carefully framed, very restricted factual issue is all that is involved and that this Court, five years ago, laid to rest all of Radiant's defenses against validity including specifically the Section 112 defense. This new attempt of Radiant's, we submit, should be disposed of summarily.

THE VALIDITY OF THE PATENT HAS BECOME THE LAW OF THE CASE.

Orderly judicial procedure requires a finality to decisions of the Appellate Court on the same issues and between the same litigants. The policy behind the rule was stated by this Court in *Woodworkers Tool Works* v. *Byrne* (9 Cir. 1953), 202 F. 2d 530, 531:

"The rule is grounded in large part on the policy of ending litigation, and in some instances on the want of power in an appellate court to modify its own judgments otherwise than on a rehearing. And it has been pointedly observed that if the practice were not followed, changes in the personnel of the Court would produce confusion. Clary v. Hoagland, 6 Cal. 685; Oakley v. Aspinwald, 13 N. Y. 500, 501. For a comprehensive statement of the doctrine and for citations of the almost numberless cases bearing on it, see 5 C. J. S. Appeal and Error, Sect. 1821 et seq.; 21 C. J. S., Courts, Section 195 et seq."

Deviations from this well established principle are few and occur in only the most exceptional cases. Generally speaking, the only exceptions to the principle occur where: (1) there is an intervening decision of a Federal Court of equal dignity, or of a higher court holding directly opposite on the identical question presented; (2) there is an intervening controlling decision by a State court of last resort interpreting state law contrary to the interpretation given it in the previous Federal Court decision; (3) new evidence and new issues* are presented for consideration on the second appeal; or (4) the decision appealed from was not in that stage of finality that it can be said to have been completely adjudicated.

Radiant attempts to slant its arguments to fit (1), (3) or (4) of these remote exceptions. Taking the arguments in order in which they are advanced, the first argument (ROB 45 et seq.) is to the effect that the prior appeal decision was interlocutory and had therefore not reached that stage of finality required by the doctrine of "law of the case". In doing so, Radiant applies an extremely liberal interpretation to the word "interlocutory". In the instant case, the validity of the patent was affirmed some five years ago by this Court, and except for completion of the accounting procedure, that decision is now final and unappealable.

The fact situation presented here finds an exact parallel in Coleman Company v. Holly Manufacturing Company (9 Cir. 1959), 269 F. 2d 660. In Coleman, this Court had before it an appeal from a judgment for contempt. Appellant nevertheless attempted to reargue the questions of validity and infringement of the patent, but this Court properly resisted this attempt. After reviewing the attempts of appellant to inject these issues in the appeal proceeding, the Court held (p. 664) in language which is precisely applicable here:

"We have spelled out the appellant's contentions in this respect at such length because we are convinced that the appellant, despite its initial lip-service to the weight to be given to this Court's previous holding

^{*} Here the same issue was fully tried and there was no new evidence that Radiant could not have presented at the original trial. The Trial Court denied Radiant's post-trial motions for new trial to bring in much the same evidence (e.g., that with regard to the benzene test, OR 211-219), and this Court affirmed such denial (299 F. 2d 160, 169).

that the patent in suit is valid and has been infringed, is still unregenerate and unconvinced. On the adjudicated issues of validity and infringement, the appellant's corporate head is bloody but unbowed.

"The point that we are here making is not a technical one. It relates to a salutary principle, firmly imbedded in the law. Again and again we are told that 'There must be an end to litigation', and yet attorneys still seek to relitigate adjudicated issues.

"For a century and a half, our Supreme Court has hammered home the principle that, on a second appeal, the higher court is confined to a consideration of the proceedings that took place in the trial court after the mandate in the first case was handed down. Matters that were adjudicated on the first appeal are no longer open to re-examination." (Emphasis supplied.)

The fact situation in the Marconi case, (Marconi Wireless Co. v. U. S. (1943), 320 U. S. 1), is inapposite. In that case a Commissioner found that one claim 16 of the patent defined new and useful subject matter, and that defendant's apparatus came within the terminology of that claim. The defendant filed no objections to the Commissioner's findings, nor did it make any contention that such claim was invalid and not infringed. After the decision of the Court of Claims holding the claim 16 to be valid and infringed, the case was referred back to the Commissioner for an accounting. At that time, defendant offered prior art (previously of record) not as evidence to show invalidity but only to show justification for the accused structure. The United States Supreme Court, on certiorari, acting as the first appellate body under the special practice relating to the Court of Claims, held that while this same evidence had been before the Court of Claims, such evidence may not have been considered by the Court of Claims when it held claim 16 valid and infringed (p. 47).

Here, the question of indefiniteness of the claims has been fully considered and decided by both the District Court and the Court of Appeals (Appellant's Opening Brief, on the first appeal, specified as Error No. 32, failure of the patent claims to comply with 35 U. S. C., Section 112).

Simmons Co. v. Grier Bros. Co. (1922), 258 U. S. 82 is not a precedent favorable to Radiant's position. In that case, there were conflicting decisions rendered by Courts of Appeal of two different circuits on the validity of the same patent. Such a situation brings into play the abovementioned exception (1) to the "law of the case" doctrine.

In *United States* v. *U. S. Smelting Co.* (1950), 339 U. S. 186, there was a decree for a preliminary injunction, not appealed, which was held by the Supreme Court not to constitute the law of the case because it was not a final judgment. The facts of that case are wholly inapplicable to the fact situation presented here.

Connor v. New York Times Company (5 Cir. 1962), 310 F. 2d 133 arose out of a previous interlocutory appeal overruling a motion to quash service of process. This case was held to deviate from the "law of the case" doctrine because, first, there was not a final judgment involved, and, second, there was an intervening decision of the State Supreme Court creating a new situation.

The second point urged by Radiant (ROB 47 et seq.) is that the Section 112 defense was not fully considered and adjudicated in the first opinion. This argument can be fully answered by reference to the opinion of this Court, 299 F. 2d 160, where at page 166 it held:

"Nor can it be said that this failure to specify the critical limit precisely results in a fatal vagueness of description. The claim must be sufficiently clear to allow others to reproduce the result at the end of the monopoly period and to enable contemporary inventors to ascertain whether or not they are infringing.

"Upon this point the District Court concluded:

'When the general description, the specific examples, and the claims are read together, the invention is so plainly defined that no one skilled in the art should have any difficulty in practicing it.'

"The record supports this statement. There is testimony to the effect that 'sufficient melamine to render the resin substantially insoluble' is a simple, clear test for an ordinary chemist to perform and one which does not require extensive experimentation in order that the precise critical limits be ascertained in a particular case.

"Under such circumstances, the fact that some preliminary testing is required does not render the claim invalid for *vagueness*." (Emphasis supplied.)

Thus, this Court has previously ruled upon the sufficiency of the patent to meet the standards set by Section 112. This issue is no longer open to Radiant on this appeal.

The third point argued by Radiant (ROB 49 et seq.) is that there has been a significant change in facts and circumstances warranting a review of the earlier decision. This is based upon the spurious premise that the testimony during the evidentiary hearing was at variance with the evidence adduced during the original infringement trial.* We have fully refuted this contention in our reply to Question 1 in the preceding portion of this brief, and we shall not repeat those arguments here.

Lastly, Radiant argues (ROB 75 et seq.) that intervening case law requires a reexamination of the decision on

"This under hornbook rules we cannot do. Where, as here, there is substantial conflict in the evidence, a court of appeals can not substitute its judgment for

that of the trial court."

^{*} As was held in *Coleman Company* v. *Holly Manufacturing Company* (9 Cir. 1954), 269 F. 2d 660, 665, where appellant urged this Court to "re-assess the evidence and find the District Court weighed-it wrongly."

the original appeal. In point of fact, Radiant's so-called "sounder cases . . . since the earlier appeal" which bear upon the Section 112 defense are strictly reaffirmations of case law that existed long prior to the decisions handed down by this Court in this litigation.

Radiant can find little solace in the case of Nelson v. Batson (9 Cir. 1963), 322 F. 2d 132. In that portion of the opinion which dealt with Section 112, the Court applied the test laid down by two old Supreme Court cases: Brooks v. Fiske (15 How. 212, 214-215 (1853) and Evans v. Eaton, 7 Wheat. 356, 434 (1822). There is nothing in the Nelson case which would indicate any deviation from the standards laid down in those Supreme Court cases decided more than one hundred years ago.

The First Circuit case of H. C. Baxter & Bro. v. Great Atlantic & Pacific Tea Company (1 Cir. 1965), 352 F. 2d 87 was a per curiam affirmance of the opinion of the District Court in Maine. Reference to the District Court's opinion (236 F. Supp. 601, 612) shows that the Court applied the reasoning in the old General Electric case (304 U. S. 364) in arriving at its conclusion. The most recent case cited by that District Court in discussing the proposition of indefiniteness was a 1943 case and the earliest was a Supreme Court decision of 1847. The Baxter case evidences no intent to depart from the principles set forth in these citations and it would be frivolous to say that this decision in some way modifies the long-standing law on the subject of the extent to which the "law of the case" can be disregarded.

The patent involved in McCulloch Motors Corporation v. Oregon Saw Chain Corp. (S. D. Cal. C. D. 1964), 234 F. Supp. 256 was held invalid on the basis of the General Electric case which the Court characterized as the leading case on the subject (234 F. Supp. 259). The patent here in

suit has already successfully met this challenge. Indeed, Judge Merrill speaking for this Court (299 F. 2d 160, 166), devoted almost an entire page to a discussion of the *General Electric* case and specifically held:

"In the General Electric case, the effect of the functional language was to broaden the claim to include all grains of whatever size or shape so long as they would accomplish the desired result. In our case the critical area is not enlarged in such a fashion. The critical point remains the same for each melamine compound used. It simply is not specified. But whether specified or unspecified the scope of the claim is precisely that of the invention." (Emphasis by the Court.)

The case of Johnson & Johnson v. Kendall Company (7 Cir. 1964), 327 F. 2d 391 cited the General Electric case, supra, as the sole authority for the proposition that the claim may not be functional at the exact point of alleged novelty. Considering that the Seventh Circuit Court did not even base its decision of patent invalidity on this section of the statute, one wonders how counsel for Radiant can seriously urge that the Johnson & Johnson case is that type of intervening decision which would require or even justify a relaxation of the "law of the case" doctrine.

In AR Inc. v. Electro-Voice Incorporated (7 Cir. 1962), 311 F. 2d 508, the Court affirmed a District Court finding of invalidity mainly on the basis of lack of invention, but also considered that the claims did not meet the measure of definiteness required by the General Electric case. There is nothing in this decision which would indicate a departure from or an extension of the General Electric case. Since this Court has already found that the claims at bar satisfy the standards of definiteness set forth in the Gen-

eral Electric case, the AR decision is not pertinent to any issue presented in this Appeal.

The case of Marshall v. Procter & Gamble Manufacturing Co. (D. C., Md. 1962), 210 F. Supp. 619 dealt with claims to a cake of soap and to the method of making it. The Court in that case found certain phrases in the claims, such as "good", "highly" and "excellent" to be indefinite. In support of its position, the Court relied upon the General Electric case, supra, and other cases which had been handed down long before the present case went through its original trial, and even before the patent in suit issued.

In summary, Radiant has cited no case which could be considered an "intervening" case justifying a reexamination of the specific holding of definiteness under Section 112 made by this Court in its 1961 decision.

CONCLUSION

Based upon the foregoing facts and arguments, and upon the clear and unequivocal findings of fact of the District Court, Switzer respectfully submits that the District Court's Decision should be affirmed in all respects; that Radiant should be adjudged in contempt because its infringing 4-C pigments are in violation of the Writ of Perpetual Injunction, dated May 2, 1962; and that this Court should reaffirm its 1961 decision as to the validity of the patent in suit.

Switzer further submits that it is entitled to treble damages on the grounds that Radiant's infringement has been willful and deliberate (35 USC Sec. 284) and is entitled to the allowance of reasonable attorneys' fees under Sec. 285.

Respectfully submitted,

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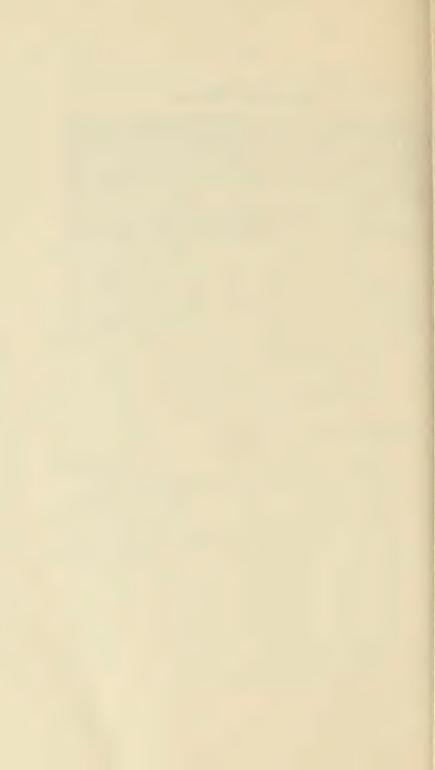
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Dated at Chicago, Illinois, August 31, 1966.

CERTIFICATE OF COUNSEL.

I certify that, in connection with the preparation of this brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

BENJAMIN H. SHERMAN,
Attorney for Defendant-Appellee.



No. 20944

In the

United States Court of Appeals

For the Ninth Circuit

HARRY P. LOCKLIN and ELMER J. BRANT, general partners doing business under the firm name of Radiant Color Company,

Plaintiffs-Appellants,

VS.

SWITZER BROTHERS, INC.,

Defendant-Appellee.

Appellants' Reply Brief

FILED

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This Court, in reviewing the briefs thus far filed, may encounter some doubts because Radiant in its Opening Brief has treated the evidence and the law on each of the two questions which it has presented for review as being distinct from each other and as resting on its own merits whereas Switzer has intermingled its response. Radiant, in its discussion of the merits of the contempt appeal, accepted fully and without qualification the doctrine of the law of the case and argued on its own merits the proposition that the accused pigments did not infringe the Kazenas claims. After having so argued, Radiant then directly, and not obliquely as suggested by Switzer (Sw. Br. 33), urged that this Court should reconsider its earlier holding that the Kazenas patent complied with U. S. Code, Title 35, Section 112. Switzer has so intermingled references to Radiant's contentions on both issues,

as well as its limited responses to Radiant's argument, that Radiant now emphasizes that each of the two questions is presented on its own independent merits. There was, and is, no intent or desire on the part of Radiant to intermingle the several contentions made with respect to each of these two fully independent questions.

With this foreword, Radiant discusses the two questions independently and now shows that—

Switzer's contentions that Radiant does infringe the Kazenas claims should be rejected

On the merits of the only issue which this Court directed the District Court to determine, Radiant's reply, in general, to the contentions advanced by Switzer could be nothing more than a repetitious restatement or re-emphasis of that which Radiant has already set forth in its Opening Brief. Therefore, rather than to belabor a 'tis 'tisn't argument in this brief, Radiant responds directly only to certain highlights of Switzer's brief. Before so doing, Radiant correlates those portions of the presently filed briefs and submits its reply in general as follows:

Switzer's general point that the evidence and Radiant's admissions establish infringement (Sw. Br. 10-12) is submitted upon Radiant's preliminary discussion of evidence on the first question (R. Br. 8-12), Radiant's point that the District Court erred in its choice of test resins (R. Br. 13-20) and Radiant's summation (R. Br. 32).

Switzer's contentions regarding the lapse of time for evaluating insolubility (Sw. Br. 12-17) are submitted on Radiant's argument that the District Court erred in lapse of time for evaluating insolubility (R. Br. 23-32).

Switzer's contentions regarding the benzene issue (Sw. Br. 17-21) are submitted on Radiant's argument that the District Court erred in defining aromatic hydrocarbon solvents (R. Br. 20-23).

Switzer's contentions on the quantitative test results (Sw. Br. 21-25) are submitted on Radiant's argument that the District Court erred in considering quantitative tests of solubility (R. Br. 33-36).

Switzer's contentions on the urea issue (Sw. Br. 25-30) are submitted on Radiant's argument that the District Court also erred in its evaluation of the urea containing test resins (R. Br. 36-39).

Switzer's contention that Rule 52(a) controls the issues on appeal (Sw. Br. 30-32) is submitted on Radiant's argument that Rule 52(a) does not control the issues on this appeal (R. Br. 12-13).

Before discussing specific issues, Radiant apologizes both to this Court and to Switzer for the trouble and confusion which Radiant may have occasioned in connection with specification 1 (Sw. Br. 5-7). As written (R. Br. 5), specification 1 is plainly wrong. That specification should have read that the District Court erred:

1. When it failed to find that tests made with Radiant's interpartes test resin produced on September 2, 1965 proved that a resin made with the melamine, sulfonamide, and aldehyde raw materials as used in the manufacture of the accused pigment is not one which will remain free flowing in either of the aromatic hydrocarbon solvents benzene or toluene;

Radiant asks leave to correct that specification. No prejudice can arise out of recasting specification 1 for the simple reason that the argument on specifications 1 through 8 shows that such was the true intent of the specification (R. Br. 13-20). The accused pigment per se was admitted to be free flowing in both solvents on the initial contempt appeal and on this appeal as well (R. Br. 38-39).

Another preliminary matter concerns Switzer's contention that a certain statement of Radiant's expert, Mr. Bennahmias, "is binding upon Radiant as an admission that a 7-4-1 MSF resin (without urea) can be made that is substantially insoluble in aromatic hydrocarbon solvents" (Sw. Br. 26). That statement relied upon by Switzer as an admission was not, in fact, made by Mr. Bennahmias, and Radiant asks that the inaccuracy be corrected by a Motion to this Court, supported by affidavits of the court reporter, the witness and one of plaintiffs-appellants' attorneys.

The reported statement at page 446, lines 7-10 of the transcript, is almost directly opposite to the actual testimony of the witness. The supporting affidavit of the court reporter clearly shows that the transcript on file is in error and that the transcript, page 446, lines 7-10, should read:

"THE WITNESS: According to my experience, I am positive that you could make a resin of the 7-4-1 proportions and obtain substantially solubility in aromatic hydrocarbon solvents."

While the foregoing statement is garbled or ungrammatical, its import is clearly to the effect that according to the witness's experience resins made in the 7-4-1 proportions would be substantially soluble rather than substantially insoluble in aromatic hydrocarbon solvents. Mr. Bennahmias throughout his testimony consistently maintained that resins made in the 7-4-1 proportions could not be made substantially insoluble in aromatic hydrocarbon solvents (RT. 409-410; 418; 420-421; 467-468). This point was made in so many instances, it is peculiar that Switzer could be confused or misled by the erroneous transcript. In any event, Radiant should not be bound by an erroneous transcript of an "admission" which was never made.

On the merits of the infringement issue, Switzer's principal and all pervading point is that the "simple, clear test" to which this Court referred in its initial holding is a quick qualitative test,* using toluene, which required only 24 hours, or, at most, less than a week to carry out. This test forms the keystone for Switzer's entire argument (Sw. Br. 2-4, 6-7, 10, 29, amongst others). Switzer even goes so far as to say that this Court had reference to that test in its first opinion (Sw. Br. 2, 14, 31) and that it became "the law of the case" (Sw. Br. 3, 7, 19, 29). Switzer urges that such test is "the only correct basis" (Sw. Br. 10).

^{*}Reference in this brief to a ''quick qualitative test' refers to the peculiar quick test adopted and used by Switzer in connection with the contempt proceeding. It is not to be confused with Dr. Hatcher's test which is quick to perform but required subsequent observation to demonstrate at least a four-months free flowing capability.

Here then is a clearly defined issue which this Court may truly find decisive of the merits on the appeal. Indeed, if Switzer correctly recites the "simple, clear test" which this Court adopted in the first instance, the judgment below *must be* sustained on the merits. Radiant cannot soundly urge, and it does not urge, that any of the test resins failed to meet that test.

Radiant's burden on this crucial issue, therefore, is to demonstrate that the "the only correct basis" which Switzer now urges is not a test upon which this Court relied in the first instance and that such a test could not have been deemed controlling. In making this demonstration, Radiant pursues every area of true substance which could conceivably relate to such a test and submits that such demonstration proves the error of Switzer's contention.

- 1. Notwithstanding Switzer's repetitious assertions that this Court did rely upon such a test, it should be conclusive on this issue that this Court in its earlier opinion did not even use any of the words "quick," "qualitative," "toluene," "24 hours," or "one week" at any place in its entire decision. Radiant assumes that, if this Court had reference to a test based upon such considerations, it would have said so. At any rate, Radiant submits, "Certainly, omissions do not constitute a part of a decision and become the law of the case . . ." [Hartford Life Ins. Co. v. Blincoe (1921), 255 U.S. 129, at page 136].
- 2. This Court's reference to "testimony" upon which it referred to find the presence of "a simple, clear test" does not state that the test is one of the peculiar character proposed by Switzer. This Court, as did Judge Goodman, relied upon the testimony of Dr. Hatcher on all critical issues. His testimony with regard to the solubility test which supported this Court's determination that there was "a simple, clear test" is simply stated in one question and answer (OR 397):
 - "Q. How difficult is the solubility test for a resin?
 - "A. It is not difficult. It is readily observable."

He did not qualify the test. He demonstrated that the Kazenas resin was insoluble in toluene by showing that it remained free flowing after a lapse of more than four months (OR 400-401, 412). Such a test is not difficult and it is readily observable. It fulfills this Court's reference to "a simple clear test." Dr. Hatcher never did testify directly or inferentially that the quick qualitative test now proposed by Switzer was sufficient to evaluate substantial insolubility of any resin. Radiant challenges Switzer on the oral argument to quote any testimony of Dr. Hatcher used in the original trial for thus evaluating substantial insolubility.

3. Switzer should not now be permitted to argue that it adopted and used in the original trial any test which required only 24 hours or, at most, less than a week to carry out. If that had been its position at the original trial, there would have been no point in Switzer arguing, as it did in its Brief for Defendant-Appellee in No. 16,780.

In that brief, Switzer, in the introduction to its argument that the original findings of fact were based on the record, stated, p. 5:

"... We propose to show, in detail and by reference to the transcript of the record, the evidentiary bases for each of the main findings of fact set forth in the Memorandum of Court (recited substantially verbatim in the headings below):"

Under its heading, page 8, "The Kazenas resin is insoluble in common paint solvents such as aliphatic and aromatic hydrocarbons, and hence, can be suspended in such vehicles without coalescence or aggomeration (R. 125)", Switzer said, pages 9-10:

"... Dr. Hatcher explained to the Trial Court that when he dispersed the Kazenas Example 5 resin in toluene: 'It did not agglomerate. It remained free-flowing' (R. 400).

"This initial toluene insolubility test for the Kazenas resin of Dx. N had been carried out some four months before the trial (R. 401), yet Dr. Hatcher was able to demonstrate these test results to the Court at the time of trial since the resin was still free-flowing in Dx. N. (R. 401). . . . "

Later, under its argument, page 22, that "The only prior art reference specifically describing the modification of a sulfonamide-aldehyde resin with melamine is the Japanese patent No. 181,405 for a method of producing a highly waterproof paratoluol-sulfamide resin of a high melting point . . . but it differs in at least one vital respect in that it is soluble in aromatic hydrocarbons, while

the Kazenas resin is substantially insoluble' (R. 131, 132)", Switzer stated, page 25:

"... Dr. Hatcher explained to the Trial Court that when the Kazenas Example 5 resin was tested for insolubility by dispersing it in toluene: 'It did not agglomerate. It remained free-flowing' (R. 400). Such testing took place some four months before the trial (R. 401). Since then, Dr. Hatcher had retained Dx. N in his possession and was able to demonstrate to the Trial Court that the resin was still free-flowing at the time of trial (R. 401)...."

Still later, in answer to Radiant's contentions on the new trial issues, Switzer said, page 70:

"Here the Trial Court had the opportunity at the trial of seeing Exhibit N in the condition of a free-flowing powder in toluene and of hearing Dr. Hatcher's testimony with regard to that exhibit. It believed Dr. Hatcher."

In the second and third of the previous quotations, Radiant has intentionally omitted all accompanying references in which Switzer tried to tie the four month test period into the pretrial affidavit of Dr. Hatcher. This, for the simple reason that this pretrial affidavit was not in evidence before Judge Goodman and Dr. Hatcher did not even purport to testify in support of that affidavit. At the trial, Dr. Hatcher's testimony was presented on its own merits. Radiant submits that Switzer's recognition that there was some permanence to be required with regard to free flowing characteristics should not be relegated to mere idle chit chat.

To the contrary, Radiant submits that the testimony and contentions to which reference has thus been made are the true support for this Court's conclusion that "The Kazenas patent is for a resin . . . which is thermoplastic but still is capable of being finely ground and which remains insoluble without agglomeration in aromatic hydrocarbon solvents." Radiant submits that Switzer's prior argument and the close tie-in between that argument and the conclusions of this Court make it most presumptive to urge that "remains" contemplates a mere ephemeral period of "only 24 hours, or, at most, less than a week."

- 4. The opinion of the District Court made upon the original trial does not support Switzer's presently adopted quick qualitative test as Switzer so confidently asserts (Sw. Br. 14). That opinion (OR 124-140) is entirely silent as to the test to be applied. The ultimate conclusion that "the functional expressions define the limits of the invention more precisely than would have been practically possible by wholly mathematical expressions." (OR 137) does not suggest any quick qualitative test which may be used to define the critical boundary line between the Japanese resin and the Kazenas resin. Nor does the earlier vital finding that the Japanese resin "is soluble in aromatic hydrocarbons, while the Kazenas resin is substantially insoluble" (OR 132) fill that void. That finding was based upon Dr. Hatcher's experiments (299 F.2d at page 163), and he demonstrated his test results after more than four months' time had elapsed. At no point in his entire opinion did Judge Goodman give the slightest inkling that he accepted, or even knew, that "the only correct basis" was the peculiar 24 hour, or less than a week, test which Switzer now proposes.
- 5. Switzer's contention that the quick qualitative test must be accepted because Radiant's expert Mr. Paulsen testified at the original trial on the basis of tests which he conducted over a period of one week should also be rejected. In the first place, his tests did not touch the issue here. Several of his test resins actually agglomerated in less than a week. Clearly, if they had agglomerated in less than a week, there was no need to watch them over a period of four months to see whether or not they would become agglomerated. But more importantly than that, it is incredulous to believe that either this Court or the District Court below did in fact rely upon any tests of Mr. Paulsen as being reliable upon this critical issue when it rejected the conclusions reached by Mr. Paulsen on those same tests. Radiant simply does not believe that this Court relied upon any of the testimony of Mr. Paulsen in sustaining the initial judgment. Radiant urges that Switzer is quite presumptive in suggesting that Mr. Paulsen was a good expert when it suits Switzer's purposes and that he

was a bad expert when it suits Radiant's purposes. He was either good or bad, but cannot logically be held to be both with regard to the same general subject matter.

In any event, Radiant submits that it did not adopt any short qualitative test as being "the only correct basis" to determine the presence or absence of substantial insolubility. Those portions of Appellants' Opening Brief on the first appeal set forth in Appendix A attached to this brief show otherwise.

6. Nothing in the patent claims or in the patent specification itself even suggests that the quick qualitative test is one to be used in assessing substantial insolubility. Certainly the words of the claim that the resin is "substantially insoluble in aromatic hydrocarbon solvents" and the words of the specification that a pigment made of the resin is "practically insoluble in aromatic hydrocarbon solvents" do not describe such a test. Certainly the words that the new resin is insoluble in many common vehicles and can therefore be suspended in such vehicles without coalescence or agglomeration do not describe such a test. Certainly the words that the pigments may be used in vehicles which are nonsolvent for the pigments to form various types of inks and the like do not describe such a test.

Dr. Hatcher, after examining the Kazenas specifications for teachings regarding insolubility, did not refer to any such test (OR 423-424, 468-469). However, since his examination was not directed to the precise nature of testing, Dr. Hatcher's attention may not have been directed to that specific issue. Radiant, therefore, challenges Switzer to quote at the oral argument any words in the specification which define or clarify the quick qualitative test which Switzer now advances.

Switzer's efforts now to rely upon extraneous considerations to read into the words "substantially insoluble" a test which is not defined in the patent should be rejected out of hand upon the authority of *Duff-Norton Company v. Ratcliff* (9 Cir. 1966), 362 F.2d 551. There the patentee tried by argument to read substance into the words "closely adjacent" as used in the claims. This Court, speaking through Judge Merrill, stated, page 553,

"'Closely adjacent,' however, is nowhere defined in the patent. The phrase appears only in the claims. Absent definition or clarification, such relative and general language cannot be held to impart patentable distinction or novelty over prior art."

It follows, by a parity of reasoning, that Switzer cannot rely upon a test which is not defined in the patent nor clarified therein.

- 7. Switzer's argument that Radiant should not now be permitted to object to the quick qualitative test because it did not put in contrary evidence at the original trial (Sw. Br. 3) should be rejected. That issue was not even before the Court at the original trial. No quick qualitative test was used to prove infringement because the original accused pigments were substantially insoluble in aromatic hydrocarbon solvents, either benzene or toluene, and remained insoluble in such solvents. Thus, the original record would not even have warranted the introduction of evidence on the adequacy of testing. In this connection, Dr. Hatcher testified unequivocally that the Kazenas resin was substantially insoluble in aromatic hydrocarbon solvents and demonstrated that it had remained free flowing in toluene for at least four months. The sufficiency of a quick qualitative test was thus not before either this Court or the District Court on the original appeal and trial. Even the substitute pigment charged as being an infringement on these contempt proceedings has remained free flowing in both benzene and toluene for a period of more than two years.
- 8. The quick qualitative test can at best make the difference between a Kazenas resin and a Japanese resin a mere difference in degree and not a difference in kind. Switzer, at the original trial and on the original appeal, persuaded both this Court and the District Court that there was a difference in kind between the two resins rather than a difference in degree. There has been no suggestion that a resin which will agglomerate in aromatic hydrocarbon solvents immediately after the passage of one day or at most one week has any practical utility over and above the practical utility of a Japanese resin. Switzer virtually concedes that its present argument requires the patent in suit to support "a distinction in degree between the insolubility of the Kazenas resin"

in the respects noted in the patent specification. Thus, Switzer argues in a full circle. It now in substance makes the same argument to sustain infringement as that which Radiant unsuccessfully made to urge invalidity on the first appeal.

- 9. Switzer's own expert on the contempt appeal admitted that the quick qualitative test was meaningless. Mr. Gray, on cross-examination, was asked the following questions on this subject matter (RT 164):
 - "Q. Is a paint in which the pigment is insoluble without agglomeration in aromatic hydrocarbon solvents in which the stuff will be agglomerated within a day, is that a salable paint?

"A. No.

- "Q. Is it salable if it will remain suspended for one week?
- "A. Probably not. It depends on your use and your customer."

Thus, at best, the quick qualitative test which Switzer now suggests has nothing to do with the issue as to whether the pigment is "practically insoluble", the words used in the specification as the predicate for the words "substantially insoluble" of the claims. Switzer's test makes the patent a mere hunting license, wholly unrelated to the world of commerce. But, in Brenner v. Manson (1966), 383 U.S. 519, an opinion by Mr. Justice Fortas pointed out, page 536, "But a patent is not a hunting license. It is not a reward for the search, but compensation for its succesful conclusion. [A] patent system must be related to the world of commerce rather than to the realm of philosophy. . . . "

That the quick qualitative test is the only test is pure philosophy, nay even fantasy. Switzer has never shown such a test has any utility whatsover, either on this appeal or on the prior appeal. As Judge Sweigert found, "the testing of a resin in any pure aromatic hydrocarbon solvent is merely an indication of the substantial insolubility of the resin in a paint vehicle." (CT 114). Yet it is now binding upon all courts that "Congress intended that no patent be granted on a chemical compound whose sole 'utility'

consists of its potential role as an object of use-testing" [Brenner v. Manson (1966), 383 U.S. 519, at page 535]. Switzer suggests no purpose other than the object of use testing for its quick qualitative test.

Switzer's reliance upon Research Products Co. v. Tretolite Co. (9 Cir. 1939), 106 F.2d 530 (cited Sw. Br. 20) illustrates the deficiencies in Switzer's present contention that the quick qualitative test is "the only correct basis" (Sw. Br. 10). In Research Products. the patent specification clearly spelled out the nature of the modified fatty acids and sulfo-fatty acids involved in the action (106 F.2d at p. 533). In the case at bar, the quick qualitative test is not spelled out any place as being "the only correct basis" (or for that matter any basis at all) for deciding the critical issue of infringement involved on this appeal.

That Research Products is not entitled to embrace a situation where the specification is silent as shown by its distinguishment in Van Brode Milling Co. v. Cox Air Gauge System, Inc. (9 Cir. 1960), 279 F.2d 313, at page 318.

In summation, Radiant urges that the quick qualitative test now adopted by Switzer as "the only correct basis" (Sw. Br. 10) should be rejected. If this is the proper test, Switzer has only demonstrated that the patent and the prior judgment as well are invalid. But validity must be assumed on the merits of the contempt charge (Sw. Br. 19, adopting R. Br. 23). If this is not the proper test, then Switzer has shown no other basis for carrying its burden of proof on the contempt issues. In either event, the judgment should be reversed on the merits.

Having thus far accepted full validity of the patent and earlier decree, and having now argued that the contempt judgment should be reversed on its own merits, we turn to the second question and urge that—

This Court should overrule its prior judgment and hold the Kazenas patent invalid under U. S. Code, Title 35, Section 112

Radiant submits that Switzer has evaded the crux of Radiant's argument on this important issue. Switzer, in a single paragraph

(Sw. Br. 38), casts aside Radiant's crucial point that there has been a significant change in facts and circumstances on the ground that it is based upon "spurious premise" which has been "fully refuted" in Switzer's response to Question 1. Radiant submits that Switzer has made no response at all to Radiant's propositions that Switzer has now proved that:—there is no critical point which remains the same for each melamine compound (R. Br. 50-62); the general description does not define the invention (R. Br. 62-66); there is no clear test to determine substantial insolubility (R. Br. 66-71); and aromatic solvents are indefinite (R. Br. 71-75). Switzer's argument on the merits of the appeal is not truly directed to the merits of any of those points. All quotations by Radiant to testimony are taken directly from the mouths of Switzer's own experts. The facts, Radiant submits, thus stand conceded.

To these conceded facts, there should now be added the new ambiguity which Switzer has created by its present contention that the quick qualitative test in toluene is the "only correct basis" to determine whether the amount of melamine is sufficient to render the resin substantially insoluble in aromatic hydrocarbon solvents. Certainly when one can argue so forcefully that the claims are to be construed by reference to a quick qualitative test after having relied upon a four month history of free flowing capacity to maintain novelty, he should not be permitted to maintain that his claim to invention is particularly pointed out and distinctly claimed as required by the statute.

Indeed, the mere fact that Switzer must now rely upon credibility of witnesses to help delineate the claims (Sw. Br. 13, 30-31) proves that the claims themselves are not definite or precise. They now mean whatever any witness who is deemed credible by the Court says they mean. Congress could not have intended so subjective and flexible a standard in drafting the statute. The admittedly relative, comparative language used in the Kazenas claims (Dr. von Fischer, RT 228-230, 248, 250, 253) and the position taken by Switzer on the contempt proceedings now brought under

the claims of that patent illustrate the hazards of carving any exception in this case to the sweeping demand which Congress made in U. S. Code, Title 35, Section 112 [Cf. Halliburton Co. v. Walker (1946), 329 U.S. 1, at p. 11].

Radiant now replies to issues upon which Switzer has made a specific response.

Switzer's first point is that Question 2 is not properly before this Court because that question was not remanded to the District Court, was not presented to that Court and was not passed upon by that Court (Sw. Br. 4, 33). Radiant submits that the question is one under the sole control of this Court, that Radiant had no right to present that question to the District Court and that the District Court had no right to deviate from the law of the case without express permission of this Court [Atlas Scraper and Engineering Co. v. Pursche (9 Cir. 1966), 357 F.2d 296]. This Court, in the exercise of its sound discretion, denied to Radiant the privilege to present an appropriate motion to the District Court (Order entered April 20, 1966, on Radiant's Motion for Leave to File Second Petition for Rehearing). Thus this Court has reserved to itself sole jurisdiction to reconsider its earlier decision—if it chooses to do so.

Switzer's second point is that deviations from the law of the case are few and occur in only the most exceptional cases (Sw. Br. 34-35). The parties are in full accord on this issue (R. Br. 41-45). This Court has well noted that "While the power to reexamine questions previously determined should be sparingly exercised, there are occasions when justice requires that course." [United States v. Fullard-Leo (9 Cir. 1946), 156 F.2d 756, 757]. Radiant urges that this is one of those occasions.

Radiant appeals entirely to this Court's discretion in presenting this issue and trusts that no longer will this Court deem Radiant to be a "disgruntled litigant" (299 F.2d at p. 169). Switzer's suggestion, by quotation from Coleman Company v. Holly Manufacturing Company (9 Cir. 1959), 269 F.2d 660, at 664, that Radiant "is still unregenerate and unconvinced" (Sw. Br. 36) should be considered, Radiant submits, in the light of what Switzer's experts

have admitted to be the true facts, in the light of the case law which has developed since the earlier decision and in the light of Switzer's present contentions on the contempt proceedings.

Switzer's third point is that Radiant is in error in urging that the prior judgment is interlocutory (Sw. Br. 35-37). Radiant submits the issue on the authorities set forth in its opening brief (R. Br. 45-47).

Switzer's fourth point is that Radiant is in error in urging that this Court did not fully cover the statute on the first appeal (Sw. Br. 37-38). Radiant's argument (R. Br. 47-49) was based upon the specific language of this Court in opening and closing its discussion of the issue, to-wit (299 F.2d 165, 166):

"Radiant's second attack upon the validity of the patent is addressed to the fact that the limits of melamine are expressed in functional language. . . ."

* * * * * * *

"We conclude that the fact that the limits of melamine are, in the claims, stated in functional language does not render the patent invalid."

Radiant does not understand that this Court did in fact intend to dispose of the balance of its earlier argument upon the inferential basis of the italicized language which Switzer quotes (Sw. Br. 38). If this Court did, however, intend so to do, then Switzer's point is, of course, well taken. But then the new facts and circumstances which Switzer has now injected in the case establish that Switzer led this Court into clear error in reaching those italicized conclusions and they justify a reconsideration upon the basis of the authorities set forth at pages 49-50, 58-62 and 75-79 of Radiant's Opening Brief.

On this point, it should not be inferred that the defense was actually covered by the affirmation of the opinion of Judge Goodman. Judge Goodman, likewise, limited consideration of the statutory issue to the functional language as appears from his statement (OR 136), "It is urged that the claims are void because the maximum and minimum limits of the melamine compound are

expressed partially in functional terms. He did not cover the question of whether the claims particularly point out and distinctly claim the invention which he found to be present in the Kazenas patent.

Switzer's last point is that the recent decisions upon which Radiant relies "are strictly reaffirmations of case law that existed long prior to the decisions handed down by this Court in this litigation" (Sw. Br. 39, 38-41). This is precisely Radiant's point (R. Br. 75-79). Somehow or another Switzer must have left this Court with the earlier impression that such prior case law was technical and out of date and that it should have been discarded or distinguished.* Certainly, Switzer convinced Judge Goodman that at least a part of Radiant's attack on claimed defects in the patent itself "could only be sustained by a hypercritical and piecemeal analysis of the patent." (OR 134). The current authority illustrates that the statutory requirements of definiteness and certainty are embracive in scope, important to validity, and alive today. The reassertion by this Court in Nelson v. Batson (9 Cir. 1963), 322 F.2d 132 of the principles of Brooks v. Fiske (1853), 15 How. (56 U.S.), 212, 214-215 and Evans v. Eaton (1822), 7 Wheat. (20 U.S.), 356, 434 (noted Sw. Br. 39) and the application of those same principles, without citation of authority, in Duff-Norton Company v. Ratcliff (9 Cir. 1966), 362 F.2d 551 at page 553, soundly support Radiant's thesis.

On this same subject matter but in different context, the holding that there can be no utility in a patent claim if "the metes and bounds of that monopoly are not capable of precise delineation" as expressed in *Brenner v. Manson* (1966), 383 U.S. 519, at page 534, should be equally devastating to Switzer's prior successful attempt to avoid U. S. Code, Title 35, Section 112 because "the alternative would have been to state the critical lower limits precisely" (299 F.2d at p. 165). Implicit in *Brenner* is the view that claim language must be precise. Otherwise the patent "may

^{*}For example, Switzer's written argument in its Brief for Defendant-Appellee in No. 16,780 states, p. 53, "No cases in support of Radiant's contentions, rendered since the adoption of the present Patent Statutes on January 1, 1953, have been called to this Court's attention."

engross a vast, unknown, and perhaps unknowable area." and "may confer power to block off whole areas of scientific development, without compensating benefit to the public." (383 U.S. 519 at p. 534).

In summation on this issue, Radiant submits that the flexible shifting position which Switzer has been able to take of the claims in suit in sustaining their validity on the first appeal and in sustaining contempt below is sound proof that Switzer is truly expert in "the highly developed art of drafting patent claims so that they disclose as little useful information as possible—while broadening the scope of the claim as widely as possible", an art to which the Court referred with displeasure in *Brenner v. Manson* (1966), 383 U.S. 519 at page 534.

Clearly, the rule of *United Carbon Co. v. Binney Co.* (1942), 317 U.S. 228, 237, that, "An invention must be capable of accurate definition, and must be accurately defined, to be patentable." is as sound today as it was when it was first written.

In conclusion on both issues, Radiant submits that the contempt judgment below should be reversed on the grounds submitted in support of Question 1 and that the initial judgment sustaining validity should be reversed on the grounds submitted in support of Question 2.

Respectfully submitted,

CARL HOPPE ERNEST M. ANDERSON

Attorneys for Plaintiffs-Appellants

Dated at San Francisco, California September 9, 1966

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CARL HOPPE,

Attorney for Appellants.

(Appendix A Follows)





Appendix A

Excerpts taken from Appellants' Opening Brief in No. 16,780 which Radiant submits as showing it did not rely upon a quick qualitative test using toluene which required only 24 hours or at most one week to carry out.

FROM PAGES 56-58

The Japanese patent discloses the full substance of the alleged invention.

In the Statement of Facts we have shown that the face of the Japanese patent discloses a thermoplastic resin made by cocondensing formaldehyde, sulfonamide and melamine. The face of the patent also discloses that the specific recipe uses 5% melamine with respect to the amount of sulfonamide. The face of the patent does not disclose whether or not the Japanese resin has a sufficient amount of melamine to render the resin "substantially insoluble in aromatic-hydrocarbon solvents". However, the evidence adduced by Switzer makes clear that the Japanese resin is substantially insoluble in aromatic-hydrocarbon solvents (Spec. No. 7).

Dr. David B. Hatcher testified that the procedure of the Japanese patent was carried out under his direct supervision in his presence and that it was followed explicitly (R. 398-399). His resin had a softening point which was approximately 89° C. (R. 398) which differed from the 122° C. disclosed by the Japanese patent (R. 399). The result which he obtained is in evidence as Exhibit O (R. 398). Exhibit O was made by grinding the resin in a mortar and pestle, and putting 10 grams of the ground resin with 40 grams of toluene into a bottle and shaking the bottle to determine the solubility (R. 465). Dr. Hatcher testified that the resin was soluble in toluene (R. 399) and the District Court so found (R. 132). However, Dr. Hatcher's Exhibit O is before this Court for inspection. Inspection discloses that a substantial portion of the resin is agglomerated or coagu-

lated in the bottom of the jar and that this substantial portion is not in solution. Thus it is substantially insoluble.

Further, Dr. Hatcher in his affidavit filed in opposition to the Motion for Summary Judgment admitted that after a charge of 10 grams of the Japanese resin was admixed with 40 grams of toluene, that:

"* * * After standing for several days, it was found that approximately 20% of the powder was dissolved by the toluene." (R. 53).

When 80% of the resin is thus admitted to be insoluble after a period of several days and when a large portion of the resin is still not dissolved after the resin has been in contact with the toluene for a period of several years, one could ask for no more conclusive proof that the resin was "substantially insoluble" regardless of what the oral testimony might be.

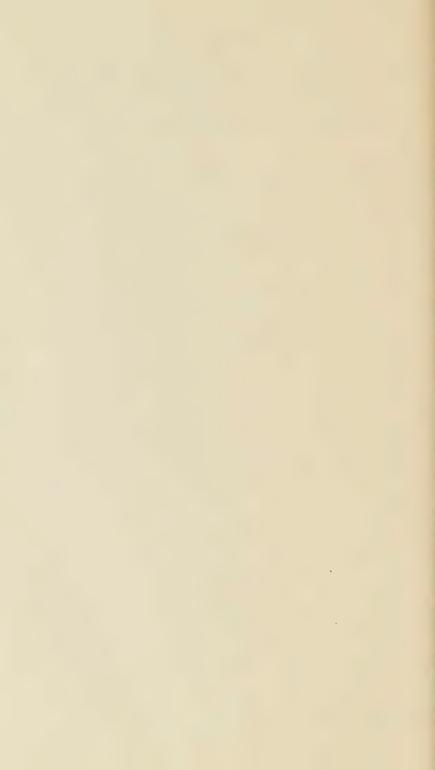
Since there is a conflict between Dr. Hatcher's oral testimony and the physical exhibit, the finding is clearly erroneous under the rule of Farmers' Cooperative Exchange v. Turnbow (9th Cir. 1940), 111 F.2d 728, 731; Galloway v. United States (9th Cir. 1942), 130 F.2d 467, 471; and United States v. Perry (8th Cir. 1932), 55 F.2d 819, 822.

Dr. Hatcher tried to distinguish the Japanese resin from the Kazenas resin by demonstrating that his specimen of the Japanese resin (Exhibit O) had agglomerated in the toluene and by showing that his specimen of Kazenas' Example 5 (Exhibit N, R. 400) did not agglomerate and remained free-flowing after being dispersed in toluene. He testified that this resin was prepared in late August of 1958, that it had been in his presence since that time, and that the resin was still insoluble and free-flowing at the time of the trial (R. 401). Subsequent developments make clear that Dr. Hatcher and the District Court both erred in the conclusion to be drawn from this testimony. Inspection of Exhibit N shows that it is not free-flowing and that it does agglomerate in a jar upon leaving it alone for a period of time. Therefore, if a difference is to be found between the Japanese resin and the

Kazenas resin arising from any alleged ability to remain free-flowing in an aromatic-hydrocarbon solvent, the evidence presented by the defendant "is positively contradicted by the physical facts" (*Galloway v. United States* (9th Cir. 1942), 130 F.2d 467, 471) and is not entitled to any credence on this appeal.

FROM PAGES 94-95

* * * The word "sufficient" does not give the slightest clue as to whether the lower limit of the melamine component is 5%; 10%; 11%; 13% or any other percentage based on the weight of the sulfonamide. The words "substantially insoluble" are not stated to be quantitative or qualitative. If the words "substantially insoluble" are words of quantitative limitation, they do not give the slightest clue as to whether substantially means 51%; 75%; 80%; 90%; 99% or any other percentage. If the words "substantially insoluble" are words of qualitative limitation denoting that the resin can be suspended in aromatic hydrocarbon solvents without coalescence or agglomeration, the claims do not give the slightest clue as to the time, temperatures or other conditions under which the resin must have that capability. Radiant submits that on their face the words "sufficient" and "substantially insoluble" do not fulfill their statutory duty of "particularly pointing out and distinctly claiming the subject matter which the applicant regards as his invention,"



No. 20944

In the

United States Court of Appeals

For the Ninth Circuit

HARRY P. LOCKLIN and ELMER J. BRANT, general partners doing business under the firm name of Radiant Color Company,

Plaintiffs-Appellants,

SWITZER BROTHERS, INC.,

VS.

Defendant-Appellee.

Petition for Rehearing

CARL HOPPE - ERNEST M. ANDERSON

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In the

United States Court of Appeals

For the Ninth Circuit

HARRY P. LOCKLIN and ELMER J. BRANT, general partners doing business under the firm name of Radiant Color Company,

Plaintiffs-Appellants,

VS.

SWITZER BROTHERS, INC.,

Defendant-Appellee.

Petition for Rehearing

Most respectfully, appellants petition the Court to grant this Petition for Rehearing on the basis of the factual determinations which this Court adopted in its opinion of October 24, 1966. There is, appellants submit, an irreconcilable conflict between the critical findings of fact which this Court made in upholding the determination that the Kazenas patent of appellee was valid, as this Court did on the first appeal, and in upholding the determination that the resin used in the accused pigment infringes, as this Court does on the present appeal.

On the first appeal, this Court clearly and unequivocably delineated the Kazenas resin as being "a resin which is a co-condensation of all three of these chemical components (melamine, sulfonamide, and formaldehyde) and which is thermoplastic but still is capable of being finely ground and which remains insoluble without agglomeration in aromatic hydrocarbon solvents." (299 F.2d 160 at page 162). By its footnote, this Court keyed the language thus delineating the Kazenas resin directly to typical patent claim 2 including its functional and comparative language "substantially insoluble in aromatic hydrocarbon sol-

vents." That finding was in keeping with the finding of the District Court in the first instance that the Kazenas resin "is insoluble in common paint solvents such as aliphatic and aromatic hydrocarbons, and hence, can be suspended in such vehicles without coalescence or agglomeration." (OR 125). The District Court clearly understood that the Kazenas resin was one which did have "the insolubility in aromatic hydrocarbons characteristic of a melamine-aldehyde resin" and, in part, it based invention on "such an advance over the prior art" (OR 133, 134). Melamine-aldehyde resins "are insoluble in aromatic and aliphatic hydrocarbons . . ." (OR 126). Thus, in the first instance the words "substantially insoluble" meant permanent insolubility in aromatic hydrocarbons, not a transient one.

On the second appeal, this Court referred to the functional language of the claims with the instruction that such functional language "did not invalidate the claims, but by the same token it served to fix precisely the limits of the claims."

Now, on this third appeal, this Court has confirmed the findings of fact which were incorporated in the latest memorandum decision of the District Court and has affirmed the judgment of contempt for the reasons set forth in that memorandum opinion. In direct and irreconcilable conflict with the earlier findings of this Court, the District Court, and this Court as well, now find the fact to be that "all resins of this type will eventually agglomerate in any pure aromatic hydrocarbon solvent. The stronger the solvent the less time it will take to agglomerate. . . ." (CT 113). By such a new finding, the District Court, and now this Court, were able to, and did, cast aside as being immaterial "The mere fact that resin agglomerates within four or more weeks in a pure hydrocarbon solvent, such as benzene . . ." (CT 114).

The conflicting findings create a true dilemma. Certainly if it is a fact, as this Court found in its first opinion, that the Kazenas resin "remains insoluble without agglomeration in aromatic hydrocarbon solvents," then a resin which agglomerates within four or more weeks in a pure hydrocarbon solvent cannot be a Kazenas resin; it must be something else. If on the other hand it is a fact, as the District Court and the Court of Appeals now

both find, that all resins of this type will eventually agglomerate in any pure aromatic hydrocarbon solvent, then it follows irrefutably that the Kazenas resin does not have "the insolubility in aromatic hydrocarbons characteristic of a melamine-aldehyde resin" (OR 133) and that thus it does not differ in kind from the Japanese prior art resin, i.e. that the words "substantially insoluble in aromatic hydrocarbon solvents" do not define patentable novelty over that prior art resin.

Indeed, this newly found fact renders the earlier finding that the Japanese prior art resin "is soluble in aromatic hydrocarbons, while the Kazenas resin is substantially insoluble." (299 F.2d 163) mere semantics. The testimony of Dr. Hatcher with respect to his experiments upon the Japanese patent to which this Court referred in the first opinion (299 F.2d 163) consisted exclusively of a demonstration which showed that the Japanese resin agglomerated in toluene whereas the Kazenas resin remained free flowing (OR 398-401, referring to Japanese resin, prior Exhibit O, present Exhibit R-33, and Kazenas resin, prior Exhibit N, present Exhibit R-32). Dr. Hatcher also testified that one would not expect solubilities in the same type of resin to change over a period of nine months (OR 407). Now, this Court accepts the fact that all resins of this type will eventually agglomerate. Thus, under the prior adopted standard of solubility the newly found fact proves that the Kazenas and the prior art resins are both soluble because both agglomerate. In contrast, under the presently adopted standards of solubility the newly found fact shows that both resins are substantially insoluble because no longer need a resin remain free flowing to be "substantially insoluble."

If the Court is of the view that the difference in standards thus stated is not as exact as set forth in the last paragraph, it then follows that the Japanese and the Kazenas resins differ only in degree depending upon how long they will take to agglomerate, an instant, an hour, a day, a week, seventeen days, a month, four months, nine months, a year, two years, or three years¹ depending

^{1.} It will be recalled that the accused pigment which consists of the adjudicated resin plus other ingredients was deposited in benzene on July 2, 1963 (Exhibit R-38, RT 374), that it was demonstrated to be free flow-

upon how high or how low one sets his sights. Thus, the basis for the earlier discard of authorities such as *Smith v. Nichols* (1874), 21 Wall. (88 U.S.) 112, 119; *Greene Process Metal Co. v. Washington Iron Works* (9 Cir. 1936), 84 F.2d 892, 893; and *Application of Aller* (CCPA, 1955), 220 F.2d 454, 456, is now proven to lack true substance.

Because this Court on the first appeal and the District Court did not believe appellants' expert² and refused to consider evidence³ that *some* of the Kazenas resins would in fact agglomerate in aromatic hydrocarbon solvents, the District Court, and this Court as well, found the fact to be that the Kazenas resin was substantially insoluble and that it thus distinguished from the Japanese resin. Now, because appellee has shown the District

ing to the District Court on October 14, 1965 (RT 375-376), and that it was demonstrated to be free flowing before this Court on the oral argument held October 11, 1966, more than three years after being deposited in benzene, whereas the District Court recognized that the accused resin part of that pigment would become agglomerated in benzene within four or more weeks (CT 114).

2. "... The experiments performed by Plaintiffs' expert to test the properties of resin samples prepared in accordance with the examples in the Kazenas patent, in the opinion of the Court, are not reliable evidence to support Plaintiffs' contention that as one approaches the lower limit of the critical range within which the melamine content may be varied the proportion of melamine is inadequate to produce the aromatic hydrocarbon insolubility claimed by the patent. . . ." (125 USPQ 519)

"Radiant contends that the record establishes that one skilled in the art could not reproduce the product from the description. It appears that the district court discounted the testimony upon which Radiant relies and favored the contrary testimony of Dr. Hatcher." (299 F.2d 166)

3. ". . . Radiant attempted to introduce new matters of evidence. . . . It offered testimony relating to post-decision tests run by it. It invited a second look at physical evidence which had been offered at trial to demonstrate the free flowing and insoluble character of the Kazenas resin, asserting that such second look would demonstrate that since trial the resin had agglomerated.

"All of this evidence was rejected by the district court for failure of Radiant to show diligence or justification for its failure to discover and present these matters at the time of trial. Radiant assigns error in this

respect but we find no abuse of discretion in this ruling."

"... If the fact was that the resin would agglomerate and would not remain free flowing, Radiant could have established this by its own pre-trial experiments and have introduced evidence with respect to those experiments at the proper time. . . ." (299 F.2d 169)

Court that *all* (not merely some) resins of this type will agglomerate, this Court, and the District Court as well, hold Radiant in contempt.

On the first appeal, appellants, in support of their plea for a new trial, urged upon this Court that the newly discovered evidence established the fact to be "that the (Kazenas) resin would agglomerate and would not remain free flowing" (299 F.2d at 169), but this Court refused to consider such evidence. Now, the District Court, and this Court as well, have permitted appellee to prove precisely that which appellants failed to prove to the satisfaction of the District Court and this Court in the first instance.

Having introduced such proofs, appellee should have been bound by the proofs for all purposes, validity as well as infringement. Otherwise, the acceptance of such proofs runs directly contrary to the controlling practice that claims should be construed the same way on infringement that they are on validity (*Minerals Separation v. Butte &c. Min'g Co.* (1919), 250 U.S. 336; and *Union Carbide & Carbon Corp. v. Graver Tank & Mfg. Co.* (7 Cir. 1952), 196 F.2d 103, cert. den. (1952), 343 U.S. 967, reh. den. (1952), 344 U.S. 849).

The conflict in findings of fact and in results warrants, Radiant submits, a rehearing of the present opinion of October 24, 1966, as well as the earlier opinion of November 16, 1961.

This Court may be of the view that it is inappropriate for it to review the evidence to determine which of the conflicting and critical findings of fact is without error and which is clearly erroneous. In that event, appellants submit in the alternative that at a very minimum this Court should vacate both the interlocutory judgment based upon the initial findings and the contempt judgment based upon the present findings and should remand the case to the District Court with directions to enter consistent findings of fact and conclusions of law on the issues of validity and infringement (Hunter Douglas Corp. v. Lando Products (9 Cir. 1954), 215 F.2d 372, 376).

Respectfully submitted,

CARL HOPPE
ERNEST M. ANDERSON
Attorneys for Appellants

CERTIFICATION

I certify that the foregoing petition, in my judgment, is well founded, and that the same is not interposed for delay.

CARL HOPPE

Attorney for Appellants

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

NEIFERT-WHITE CO.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

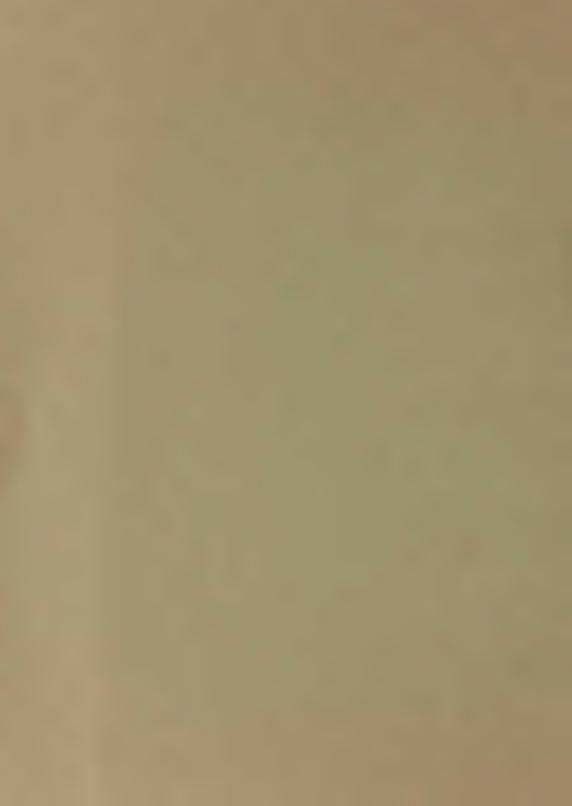
BRIEF FOR THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 20,945

UNITED STATES OF AMERICA,

Appellant,

V.

NEIFERT-WHITE CO.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

JURISDICTIONAL STATEMENT

The United States brought this action against appellee in the United States District Court for the District of Montana, under the civil provisions of the False Claims Act, 31 U.S.C. 231 (R. 2-15). After filing its answer (R. 20-26), appellee moved for judgment on the pleadings (R. 28). On December 6, 1965, the district court granted the dealer's motion and dismissed the Government's complaint (R. 38-45). On February 1, 1966, the Government filed a notice of appeal (R. 46). The jurisdiction of this Court rests upon 28 U.S.C. 1291.

STATEMENT OF THE CASE

Under the Commodity Credit Corporation's Farm Storage

Facility Loan Program, any grain grower desiring to purchase
grain storage bins could borrow from the CCC an amount not to
exceed eighty (80) percent of the "actual out-of-pocket cost
paid" for the storage bins. 23 F.R. 9686-87, as amended,
25 F.R. 1435. The grower was required to submit to the local
county Agricultural Stabilization and Conservation (ASC)
Committee, with his loan application, an invoice showing the
actual cost of the storage bins and the amount of the downpayment thereon. 23 F.R. 9687, as amended, 25 F.R. 1435.

During a three month period in 1959, appellee Neifert-White Company of Townsend, Montana, sold a number of grain storage bins to twelve grain growers and, after each sale, assisted the purchaser in obtaining a loan from the CCC, under its Farm Storage Facility Loan Program, to finance the cost thereof (R. 2-15). In rendering this assistance, an officer of the appellee prepared false invoices which showed that the purchase price of the bins sold to the growers to be greater than the actual purchase price (R. 2-15). These invoices were submitted, along with the growers' applications to the ASC

^{1/} See 15 U.S.C. 714b(h).

The relevant facts are derived from the pleadings, inasmuch as the case was disposed of on a motion for a judgment on the pleadings.

committee for Lewis and Clark County, Montana (R. 2-15). They were prepared for the purpose of fraudulently inducing the CCC to loan the growers sums of money in excess of that permitted under the agency's loan program (R. 2-15). On the pasis of the false invoices, the CCC loaned money to the twelve grain growers in excess of 80 percent of the bins' actual purchase price (R. 2-15).

On February 2, 1965, the Government brought this action under the False Claims Act, seeking to recover statutory foreitures totalling \$24,000 from the Neifert-White Company on the ground that it had assisted a number of grain growers in presenting twelve false claims against the United States (R. 2-15). In its answer, the defendant-dealer asserted, inter alia, that the complaint failed to state a claim upon which relief could be granted (R. 20). Thereafter, appellee moved for judgment on the pleadings under Rule 12(c) of the Federal Rules of Civil Procedure (R. 28). On December 6, 1965, the district court (per Murray, J.) granted defendant's motion and dismissed the Government's complaint (R. 45). In its opinion filed on December 3, 1965, the court held that the applications for the CCC farm storage facility loans were not "claims" within the meaning of the False Claims Act because they "were not claims * * * for money to which the borrowers were asserting a right based on some liability of the government to the borrowers" (R. 41). In the court's view, "in order for

there to be a claim within the meaning of the False Claims Act, the claim must be founded as of right upon the government's own liability to the claimant" (R. 41).

SPECIFICATION OF ERRORS

- 1. The district court erred in holding that the False Claims Act applies only to claims which are supported by an assertion of an enforceable legal right against the United States for the payment of money.
- 2. The district court erred in holding that successfully presented false applications for loans to purchase grain storage bins, under the Commodity Credit Corporation's loan program, are not claims within the meaning of the False Claims Act, 31 U.S.C. 231.
 - 3. The district court erred in dismissing the complaint.

STATUTE INVOLVED

The False Claims Act, 31 U.S.C. 231, provides in pertinent part:

Any person not in the military or naval forces of the United States * * * who shall make or cause to be made, or present or cause to be presented, for payment or approval, to or by any person or officer in the civil, military, or naval service of the United States, any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, fictitious, or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of

The court's opinion is reported at 247 F. Supp. 878.

such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry * * * shall forfeit and pay to the United States the sum of \$2,000, and, in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act, together with the costs of suit, and such forfeiture and damages shall be sued for in the same suit.

ARGUMENT

THE DISTRICT COURT ERRED IN HOLDING THAT SUCCESSFULLY PRESENTED FALSE APPLICATIONS FOR COMMODITY CREDIT CORPORATION LOANS ARE OUTSIDE THE REACH OF THE CIVIL FALSE CLAIMS ACT.

Introduction

The single issue presented by this appeal is whether the False Claims Act applies to a false and fraudulent application for a loan from a Government agency, on the basis of which application there is an actual transfer of federal funds to which the applicant is not entitled. In holding that the Act does not apply in these circumstances, the district court relied exclusively on its belief that the civil liability provisions of the Act are restricted in their operation to claims which "constitute an enforceable demand for money on the Government based on [some] liability of the Government to the [claimant]" (R. 42). There was, of course, no legal obligation on the part of the United States to approve the grain growers!

It is evident from the district court's opinion that the court was of the view that, were these applications for loans (footnote continued'on next page)

In Point I below, we shall show that this restrictive interpretation of the Act plainly cannot be squared with the construction given the statute by the Supreme Court and the courts of appeals. In Point II, we shall demonstrate that successfully presented false applications for Government loans are "claims" within the meaning of the Act.

It should be noted preliminarily, however, that the district court's reading of the Act is not only contrary to settled authority but also, if accepted, would provide an open invitation to seek to obtain by deception public monies to which there is no entitlement. For, under the district court's view, not only is the False Claims Act unavailable as a deterrent to false applications for loans but, as well, it cannot be invoked as a sanction against those who employ deceit to obtain grants-in-aid or other forms of federal subsidies for which, under the governing statutory or regulatory provisions, they do not qualify. Obviously, with few (if any) exceptions no individual has any more of an enforceable right to a grant-in-aid from the Federal Government than he does to a loan of public monies.

- 6 -

continued)
"claims" within the meaning of the False Claims Act, then
appellee's conduct -- in assisting the grain dealers to obtain
the loans by preparing false invoices which were submitted with
the applications -- would be subject to the Act.

An example of an outright subsidy program administered by the Department of Agriculture is the wool program, 7 U.S.C. 1781 et seq.

In view of the vast number of federal grant-in-aid programs and the large amounts of public monies which are annually disbursed under them, little elaboration is required as to the consequences -- in terms of the protection of the Federal purse -- of such an interpretation of the False Claims Act. But, quite apart from occasioning the frustration of the statutory purpose underlying the Act, the result of that interpretation is manifestly absurd. There is certainly no rational basis for concluding that, while the obtaining of \$1,000 in federal funds on a fraudulent claim of entitlement to the money as a matter of contract right gives rise to False Claims Act liability, the obtaining of the same amount of public monies on an equivalent fraudulent claim of entitlement to them under a legislatively created subsidy program does not produce such liability. In both instances, the relevant considerations are identical: (1) there has been a receipt of federal monies by one who is not entitled to them; and (2) the transfer of the funds took place because of fraudulent representations made to the Government.

It need be added only that, analytically, there is equally no basis for a rational distinction for False Claims Act purposes between an application for a federal loan and an application for monies purportedly due the applicant as a matter of right. The purpose of a loan application, in common with a contractually-based claim, is to obtain the transfer of

may be that the loan will be repaid, this does not mean that the applicant does not derive a direct monetary benefit from the receipt of the loan or that the United States does not incur a direct monetary disadvantage as a result of its disbursement. Leaving aside the always present contingency that the loan will not be repaid in full, under most (if not all) federal lending programs the rate of interest charged the borrower is less than that which the borrower would have to pay were the loan obtained on the same general terms and conditions from a commercial source. At least to the extent of the interest rate differential, the borrower receives a subsidy from the Federal Government. Indeed, it is doubtless the recognition of this fact that prompts most applications for loans under the lending programs authorized by Congress.

federal funds to the applicant. And, while the expectation

I.

A "claim" need not be supported by an assertion of an enforceable legal right to payment of money in order to be covered by the False Claims Act.

The False Claims Act imposes civil liability upon "[a]ny person who shall . . . present or cause to be presented,

Under some lending programs, an inability to obtain sufficient credit elsewhere at reasonable rates and terms is a statutory condition precedent to making the loan. See e.g., 7 U.S.C. 1941. Loans under such programs are thus essentially restricted to borrowers who are doubtful credit risks.

See <u>e.g.</u>, 7 U.S.C. 904, providing a 2% rate of interest on loans made by the Rural Electrification Administration to finance the construction of electric power generating and transmission facilities. And, as will be seen later, p. 24, <u>infra</u>, the loans hereinvolved bore a lower interest rate than the prevailing market rate.

for payment or approval, to or by any [federal] officer . . . any claims upon or against the Government of the United States. . . . knowing such claim to be false or fraudulent or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes . . . any false bill . . . [or] claim . . . knowing the same to contain any fraudulent or fictitious statement or entry " 31 U.S.C. 231. As previously noted, the district court held that liability could not attach in this case because the False Claims Act covers only those claims against the government which are supported by an assertion of an enforceable legal right to the payment of money and, since there was no legal obligation on the part of the United States to approve the grain growers' applications for loans, such applications were not claims within the meaning of the Act. It is clear that this construction of the Act is contrary to the great weight of authority.

1. Insofar as we are aware, there is no prior decision of any court holding the False Claims Act inapplicable on the ground assigned by the district court here. In support of its restrictive reading of the Act, however, the court relied upon a dictum in <u>United States</u> v. <u>Cohn</u>, 270 U.S. 339, 345: "[T]he provision [in the False Claims Act] relating to the payment or approval of a 'claim upon or against the Government relates solely to the payment or approval of a claim for money or property to which a right is asserted against the Government,

based upon the Government's own liability to the claimant." For present purposes, there is no need to consider whether, in 1926 when Cohn was decided, that dictum would have been applied by the Supreme Court to hold the Act unavailable in circumstances where, as here but not Cohn, the defendant's fraud induced the Government to transfer federal monies to which the applicant was not entitled. While we think there is room for substantial doubt in that regard, it is enough to note that the Supreme Court's subsequent decision in United States ex rel Marcus v. Hess, 317 U.S. 537, precluded the district court's reliance on Cohn as a basis for holding that, to be within the Act, a claim must be founded on a legal obligation of the Government. It is not without significance, we think, that, while discussing several of the decisions upon which the Government relied, the court below totally ignored Hess.

In <u>Hess</u>, several contractors had obtained, through collusive bidding, contracts with certain municipalities for the

This Court recently referred to Hess as a "leading" False Claims Act case. Woodbury v. United States, 359 F. 2d 370.

The Cohn case involved a criminal prosecution for the submission of false statements in support of an application by an importer to remove certain non-dutiable imported merchandise from a United States customs house. The Supreme Court ruled for the defendant, stating that there had been no defrauding or cheating of the Government out of any of its property or money inasmuch as the merchandise involved was not dutiable. 270 U.S. at 346-347. Thus, the Court's statement, as to what is a "claim" for False Claims Act purposes, was entirely gratuitous.

construction of various public works. The contractors were paid, not by the United States, but by the local authorities out of funds partially supplied by the Federal Public Works Administration. The district court entered judgment against the contractors in the amount of \$350,000 of which \$203,000 was for double damages and \$112,000 was for 56 violations of the False Claims Act. 41 F. Supp. 197. The Court of Appeals for the Third Circuit, reasoning that the Act was to be construed with "utmost strictness", reversed on the ground that there was no direct contractual relationship between the alleged claimants, the contractors, and the United States. 127 F. 2d 233. The Supreme Court, in reinstating the district court judgment against the contractors, specifically repudiated the Third Circuit's "interpretative approach." 317 U.S. at 540-541. The Court declared that the Act was intended "to reach any person who knowingly assisted in causing the government to pay claims grounded in fraud, without regard to whether that person had direct contractual relations with the government." 317 U.S. at 544-545.

Had the Supreme Court regarded the Act as requiring "an enforceable demand for money on the Government based on [some] liability of the Government to the borrowers" (R. 42), the government perforce would have been denied recovery in Hess This follows from the fact that the contractors' fraudulent claims -- held to be subject to the Act -- were not such enforceable demands. The Federal Government was under no

legal obligation to fund the program to which the fraudulent bids related; nor, indeed was it under any obligation to make the payments for work performed by the contractors.

While the court below also sought to derive support from <u>United States</u> v. <u>McNinch</u>, 356 U.S. 595 (R. 40, 43), the Supreme Court plainly did not there revive the requirement (if it ever existed) that the claim be "based upon the Government's own liability to the claimant." While referring in a footnote to the <u>Cohn</u> dictum (fn. 10, 356 U.S. at 600), the Court did not repudiate the <u>Hess</u> decision -- indeed, <u>Hess</u> was cited with approval. 356 U.S. at 598. In addition, the facts of <u>McNinch</u> were markedly different from those of this case and the rationale of the Court in holding the Act inapplicable has no present materiality.

The issue in <u>McNinch</u> was whether a private lending institution's application for credit insurance under a Federal Housing Administration program is a "claim" for False Claims Act purposes. Holding that it is not, the Court emphasized (356 U.S. at 598-599, emphasis supplied):

In normal usage or understanding an application for credit insurance would hardly be thought of as a 'claim against the Government.' As the Court of Appeals for the Third Circuit said in this same context, 'the conception of a claim against the government normally connotes a demand for money or for some transfer of public property.' United States v. Tieger, 234 F. 2d 589, 591. In agreeing to insure a home improvement loan the FHA disburses no funds nor does it otherwise suffer immediate financial detriment. It simply contracts, for a premium, to reimburse the lending institution in the event of future default, if any. 10/

Since there had been no default in McNinch, the Supreme Court expressly reserved decision "as to whether a lending (footnote continued on next page)

In short, the critical consideration in McNinch was that a successful application for credit insurance (unlike a loan application) does not per se call for any disbursement of federal funds or impose any immediate financial detriment upon the United States. At no point in the McNinch opinion is there any reliance upon the fact that an applicant for such insurance does not have a legal right to have the application approved by the FHA (1.e., that the application is not based upon the Government's liability to the applicant). In these circumstances, we find it difficult to understand the suggestion of the court below (R. 43) that McNinch "is directly against the Government's position, and supports [the court's construction of the Act]".

2. Not only is the holding below respecting the ambit of the term "claim" irreconcilable with the Supreme Court's decision in Hess, it also conflicts with decisions of at least five different courts of appeals; the Third, Fourth, Fifth, Eighth and Tenth Circuits. And, while the court below pointed to this Court's decision in United States v. Howell, 318 F. 2d 162,

⁽footnote continued)
institution's demand for reimbursement on a defaulted loan
originally procured by a fraudulent application would be a
'claim' covered by the False Claims Act." Fh. 6, 356 U.S. at 599.
Subsequently, in <u>United States</u> v. <u>Veneziale</u>, 268 F. 2d 504,
the Third Circuit answered this question in the affirmative.

the fact situation there presented was quite different and the rationale of the decision does not reflect a disagreement between this Circuit and the other courts of appeals.

a. The most recent decision is that of the Third Circuit in <u>United States</u> v. <u>Lagerbusch</u>, No. 15,642, decided <u>11</u>/June 7, 1966. This decision is of particular significance in view of the district court's reliance (R. 41) on <u>United States v. Tieger</u>, 234 F. 2d 589, as "being illustrative of the proposition that in order for there to be a claim within the meaning of the False Claims Act, the claim must be founded as of right upon the government's own liability of the claimant." While <u>Tieger</u>, presenting the same question as <u>McNinch</u>, does not illustrate that proposition, in any event <u>Lagerbusch</u> shows that the Third Circuit does not subscribe to it.

The defendant in <u>Lagerbusch</u> made false representations to his employer, the Hercules Powder Company, on the basis of which he received "undeserved payments of money." Hercules was operating a Government installation under a cost-plus-a-fixed fee contract under which the government paid or reimbursed Hercules for all operating costs, including the sums fraudulently obtained from Hercules by the defendant. Appealing from a

A copy of this decision will be furnished appellee when this brief is served. We anticipate that, by the time of the oral argument, it will be reported and its citation will be made available to the Court.

judgment in the Government's favor under the False Claims Act, the defendant contended that the False Claims Act was inapplicable because the representations were made to, and the payments were received from, Hercules -- not the Government. Rejecting this contention, and holding the False Claims Act applicable, the Third Circuit relied, inter alia, on United States ex rel Marcus v. Hess, supra. It added that it was "not persuaded by the argument of the [defendant] that there is anything in the earlier decision in United States v. Cohn, 1926, 270 U.S. 339, which is inconsistent with our conclusion or with [Hess]." Since obviously Lagerbusch's false claims were not "based upon the Government's own liability" to him, the Third Circuit could not have more plainly expressed its view that the interpretation of the Act adopted by the court below is (1) not compelled by Cohn; and (2) inconsistent with Hess.

In <u>United States</u> v. <u>Alperstein</u>, 183 F. Supp. 548 (S.D. Fla), affirmed, 291 F. 2d 455 (C.A. 5), the question was whether the False Claims Act extends to an application by a veteran for admission to a Veterans Administration hospital for treatment of a non-service connected disability. While a veteran does not have a legally enforceable right to treatment for a non-service connected disability in a VA institution, he may be given such treatment on a space-available basis if he is financially unable to pay the necessary expenses of hospital care. 38 U.S.C. 610. Alperstein was determined to have falsely certified such inability in his application for admission.

Under the holding below, Alperstein's application was not a "claim" since he had no more right to be admitted to the VA.hospital than the grain growers here had a right to a loan. Nevertheless, the Fifth Circuit, agreeing with the district court ruling that the application was a "claim," upheld the imposition of False Claims Act liability. And, see also, Smith v. United States, 287 F. 2d 299, 304 (where the same circuit held that "the False Claims Act applies even where there is no direct liability running from the Government to the claimant" -- a holding directly contrary to the ruling below); and United States v. DeWitt, 265 F. 2d 393, 395 (in which the Fifth Circuit applied the Act where a gratuity was paid by the Veterans Administration in reliance on a false application for a government-insured loan).

It is true that, prior to Alperstein, the Tenth Circuit had held in <u>United States</u> v. <u>Borth</u>, 266 F. 2d 521, that an application for admission to a V.A. hospital is not subject to the False Claims Act. The basis of the <u>Borth</u> decision was <u>not</u>, however, the fact that the veteran did not assert an enforceable right to hospital treatment at federal expense.

Rather, the Tenth Circuit reasoned that the Act applies only to claims for money or the transfer of property and that an application for admission to a hospital is a claim for services and not money or property. Although we think <u>Borth</u> was incorrectly decided, and that the Fifth Circuit properly refused

scarcely lends any support to the holding below here.

Moreover, subsequent to Borth, the Tenth Circuit rejected the district court's interpretation. In Sell v. United States, 336 F. 2d 467, 473-475, it ruled that False Claims Act liability attaches to the submission of false applications by farmers for assistance (in the form of surplus grains) under the Commodity Credit Corporation's 1955 Emergency Grain Feed 12/ Program. This holding, too, would not have been possible had the Act been read as requiring that the claim "be founded as of right upon the Government's own liability to the claimant" (R. 41).

In <u>United States v. Rainvater</u>, 244 F. 2d 27, affirmed, 356 U.S. 590, the Act was applied by the Eighth Circuit to false applications submitted to the Commodity Credit Corporation for the purposes of obtaining loans on cotton. The district court here endeavored to dismiss <u>Rainwater</u> on the ground (R. 42) that "the only question presented and decided was whether a claim against Commodity Credit Corporation was a claim against the United States within the meaning of the False Claims Act." While this may have been true in the

Borth was distinguished on the ground that while in that case, the purpose of the Sell claim was to obtain property. 336 F. 2d at 474.

Supreme Court, it was not so in the Eighth Circuit. As the court of appeals stated (244 F. 2d at 28), it had before it the additional question as to whether the "complaints state facts upon which relief may be granted where there has been no specific allegation of damage." And, in its discussion of that question, the court noted (<u>ibid</u>), <u>inter alia</u>, that the complaints set forth in detail "the manner in which the defendants procured the 'payment and allowance of false and fraudulent claims', (loans on cotton)". Thus, in the Eighth Circuit's view, there was no doubt that the term "claim" embraced the cotton loans made by CCC.

The Fourth Circuit's disagreement with the court below's reading of the Act is evidenced by <u>United States v. Brown</u>, 274 F. 2d 107. In that case, tobacco farmers filed false applications with a producer's cooperative for an advance of the support price of tobacco. These applications were held to be within the ambit of the False Claims Act even though not within the definition of "claim" adopted by the court below.

b. As above noted, the court below referred to this Court's decision in <u>United States v. Howell</u>, 318 F. 2d 162. That case involved false statements and records of gross receipts submitted by concessionaires of the San Francisco Bay Area Exchange, for the purpose of lessening the commission owed by them to the Exchange. This Court concluded that the statements were not claims for the purposes of the Act.

If this holding had rested upon the construction of the Act adopted by the court below, we would have had no hesitancy in asking the Court now to reconsider it. The fact is, however, that the Court neither was called upon to decide, nor did rule, that a "claim" must be based upon an enforceable demand against the United States.

What this Court found dispositive in <u>Howell</u> was that the defendants had made no fraudulent demand for money <u>from the United States</u> but, rather, had merely sought a reduction in the amount of money which they were to pay to the United States. 318 F. 2d at 165-166. In the Court's view, the Act was not intended to cover the situation where the claimant fraudulently seeks a "reduction" in the amount which he is to pay "to the Government." 318 F. 2d 166.

Whether that reading of the Act is right or wrong, it clearly has no present relevance. In sharp contrast to Howell, this case involves a false application which was designed to effect, and did effect, the transfer of money from the United States to the applicant -- not a reduction in a monetary obligation running to the United States. The distinction was recognized by this Court in Howell itself.

Noting the Government's reliance upon the Fifth Circuit's decision in Smith v. United States, supra, the Court stated (318 F. 2d 166):

We do not think that case differs in substance from the view we take and we are certainly in accord with the conclusion reached therein.

"The false claim resulted, as Smith knew it would, in the actual payment of Federal funds. That is sufficient." 287 F. 2d at 304.

In these circumstances, the reliance in <u>Howell</u> on the <u>Cohn</u> dictum (318 F. 2d at 164-5) gives no support to appellee's position. What this Court necessarily relied on <u>Cohn</u> for was simply the proposition that the "claim" must seek money or property <u>from</u> the United States. It may well be that <u>Cohn</u> provides support for that proposition. But, we stress again, where, as here, the claim does seek federal money or property, <u>Cohn</u> cannot be used to make the applicability of the False Claims Act turn on whether the claim is founded on a legally enforceable governmental liability. As five courts of appeals have expressly or implicitly recognized, such use of <u>Cohn</u> is precluded by <u>United States ex rel Marcus</u> v. <u>Hess</u>.

II.

Fraudulently induced Farm Storage Facility Program loans are covered by the Act.

We have shown to this point that the district court's interpretation of the scope of the False Claims Act must be rejected. We now show that, properly interpreted, the Act plainly embraces the loan applications hereinvolved.

1. As is reflected by the decisions discussed in Point I, the Act encompasses, at the very least, fraudulent submissions which seek the disbursement of federal funds or

the transfer of federal property. This is most certainly the thrust of McNinch: once again, the reason that the application for credit insurance was held to be outside the ambit of the Act was that the granting of the application did not occasion any immediate financial detriment to the United States since no federal monies or property were disbursed or transferred. Cf. United States v. Veneziale, supra. Similarly, in Cohn itself, the Act was held inapplicable because the false representations could have had no effect upon the federal purse. Where, in contrast to the circumstances of McNinch and Cohn, the fraudulent submission has had as its object the disbursement of federal funds or the transfer of government property, the Act has been held applicable.

In this connection, it has made no difference whether the false representations have been made directly to the United States or, as in Hess, Lagerbusch, and Brown, supra, to a third party: of controlling significance has been the involvement of federal funds or property and not the person to whom the false statement is submitted. Likewise, the courts have attached no significance to the label placed on the document containing the false statement. The "applications" in Sell, Brown and Alperstein were just as much within the coverage of the Act as if they had been denominated "claims," "vouchers" or "demands": on this aspect, as well, the critical consideration being the involvement of federal funds or property and not the caption on the document.

2. Measured by this firmly established standard, we think it beyond question that an application for a federal loan under a CCC lending program authorized by Congress -- no less than an application for feed grain under a CCC Emergency Feed Program (Sell) or an application for medical care in a V.A. hospital (Alperstein) -- comes within the Act. Its objective is the disbursement of federal funds and, when favorably acted upon by CCC, those funds are disbursed. Moreover as previously noted, that loans (as distinguished from gratuities) are subject to repayment does not mean either that the recepient derives no benefit or that the United States suffers no financial detriment from the disbursement of the loan proceeds.

The Farm Storage Facility Loan Program was established by the Commodity Credit Corporation pursuant to a mandate from Congress. In the Act of June 7, 1949, 63 Stat. 154, 156, Congress amended the Commodity Credit Corporation Charter Act, 62 Stat. 1070, and directed the CCC to "make loans to grain growers . . . when such growers . . . apply to the Corporation for financing the construction or purchase of suitable storage [facilities]."

15 U.S.C. 714b(h). Prior to this time, there had been a shortage of adequate storage facilities and, since commodities had to be properly stored "before [producers could] . . . obtain the benefits of the price-support program with respect to their crops," many farmers were unable to avail themselves of these

Farmers could not, for example, obtain loans from the CCC on their grain or cotton crop unless the commodity was stored in suitable facilities. 95 Cong. Rec. 4938. Congress intended, by enacting this amendment, to assist the farmer in solving this storage problems and thereby "make the benefits of the price-support program fully available to farmers." H. Rept. No. 418, 81st Cong., 1st Sess., p. 6.

Consistent with the congressional directive to assist farmers in establishing storage facilities on their land, a program was established whereby grain growers could borrow money from the CCC in order to purchase or construct storage facilities. The regulations, in effect at the time of the making of the loans involved herein, provided, inter alia, that any grain grower needing storage facilities could borrow an amount not to "exceed eighty percent of the actual out-of-pocket cost paid by the borrower" for each facility (Sec. 474.726(b), 25 F.R. 1435); that the "principal of the loan . . . [was] repayable in equal annual installments with interest at four percent per annum on the unpaid balance" (Sec. 474.726(c),

In addition to directing the CCC to make loans to grain growers needing storage facilities, Congress gave the Corporation authority to acquire real property for the purpose of providing storage facilities. H. Conf. Rept. No. 723, 81st Cong., 1st Sess.

23 F.R. 9688); and that the "maximum term of the loan [was] . . . four years, except that the term of an individual loan . . .[could] be extended and re-extended . . ."

(Sec. 474.726(a), 23 F.R. 9687).

The twelve grain growers evidently needed storage facilities on their farms, otherwise under the then existing regulation (Sec. 474.725(b)(4), 23 F.R. 9687) their loan applications would not have been approved by the ASC committee for Lewis and Clark County, Montana (R.2-14). Had the growers elected to finance their purchases of storage bins through conventional lending institutions, rather than the CCC, during the months of July, August and September 1959, the interest on their loans would have been substantially higher than the rate charged by the CCC. Federal Reserve Bulletin, (January 1960), p. 49. Moreover, had they obtained loans through conventional financing, the other terms and conditions of such loans would, undoubtedly, have been less favorable than those offered by CCC.

Thus, the grain growers plainly profited by the false applications and the United States was financially disadvantaged by reason of its reliance upon them. While perhaps not strictly relevant, it is very likely that appellee similarly benefited from its fraud. While its preparation, issuance and utilization of the false invoices may have been solely motivated by a desire to aid the grain growers, we think it

more likely that a principal objective was to facilitate
its sales of the bins by making it possible for its customers
to finance (by reason of the fraud practiced on CCC) a greater
portion of the purchase price.

3. These considerations explain why the only other courts confronted with False Claims Act suits involving loan applications have held the Act to be applicable. United States v. Rainwater, supra; Toepleman v. United States, 263 F. 2d 697 (C.A. 4); United States v. Cherokee Implement Co., 216 F. Supp. 374 (N.D. Iowa).

And while the opinions in Rainwater and Toepleman may not have addressed themselves expressly to the question, the Cherokee Implement decision did. There, as here, an officer of the defendant-corporation had prepared and executed an invoice containing false statements, as a result of which the Commodity Credit Corporation loaned money in excess of the amount permitted under its program to finance the purchases of farm equipment. The district court held, in denying the corporation's motion to dismiss (216 F. Supp. at 375):

The test as to whether a false claim is made against the United States is whether there is a demand for money or for some transfer of public property or disbursement of public funds.

The Toepleman case had previously been before the Supreme Court on the same issue as presented in Rainwater and was decided in the McNinch opinion, rendered the same day as Rainwater. 356 U.S. at 596.

United States v. McNinch, 356 U.S. 595, 78 S. Ct. 950, 2 L. Ed. 2d 1001 (1958 dicta). Where the United States actually makes a loan by reason of a false application, there may be a claim under the false claims statute. United States v. Rainwater, 244 F. 2d 27 (8th Cir.) affirmed 356 U.S. 590 * * * The cases since the McNinch decision have accepted this test. In United States v. Veneziale, 268 F. 2d 504 (3rd Cir., 1959), it was considered a false claim when the Government had to pay on a loan guaranteed. In all these cases where money was actually paid out in response to a false application for a loan, it was a claim within 31 U.S.C.A. §231, Smith v. United States, 287 F. 2d 299 (5th Cir., 1961); United States v. Brown, 274 F. 2d 107 (4th Cir. 1960): United States v. Globe Remodeling Co.. Inc., D.C. 196 F. Supp. 652.

The court below acknowledged the Cherokee Implement decision, but brushed it aside (R. 44) as not "convincing" -- solely because none of the cases relied upon by the Iowa district court had involved a loan application except Rainwater (which the court had previously dismissed as not having decided the question). For reasons already developed, however, the decisions in cases such as Smith and Brown plainly lend direct support to the conclusion reached in Cherokee Implement. On the other hand, the court below was unable to point to any decision holding that loan applications are outside the False Claims Act. Nor could the court cite a single decision in which the term "claim" was held not to extend to an application for the disbursement of federal monies. We reiterate that every case cited by the court below in support of the result it reached --

i.e., Cohn, McNinch, Howell and Tieger -- involved situations in which the false representations had not had as their purpose or effect the receipt of public funds to which the claimant was not entitled.

CONCLUSION

For the reasons stated, it is respectfully submitted that the judgment of the district court should be reversed and the cause remanded for trial.

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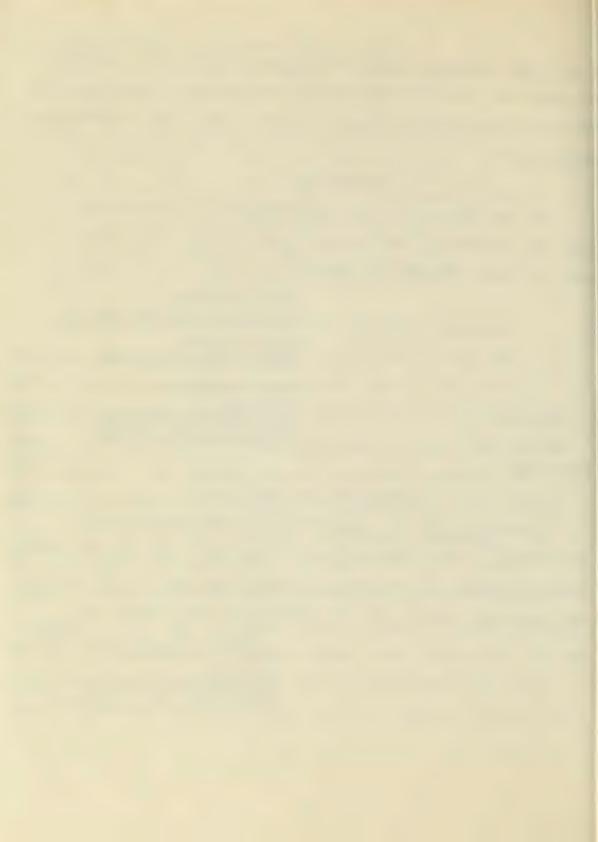
JULY 1966.

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 20,945

IN THE

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

v.

NEIFERT-WHITE CO.,

Appellee.

On Appeal from the United States District Court for the District of Montana.

Brief of Appellee NEIFERT-WHITE CO.

FILED

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No. 20,945

IN THE

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

v.

NEIFERT-WHITE CO.,

Appellee.

On Appeal from the United States District Court for the District of Montana.

Brief of Appellee NEIFERT-WHITE CO.

SUMMARY OF THE ARGUMENT

It is the apellee's position that the decision of the District court should be sustained because it correctly ascertained that the facts of this case, as stated in the Complaint, do not involve a "claim against the Government". The terms of the False Claims Act are clear in that it is obvious that a necessary prerequisite for the application of the Act is that a "claim" against the Government must be involved. A "claim

within the meaning of the False Claims Act is a claim for money or property to which a right is asserted against the Government, based on the Government's own liability to the claimant, United States v. Isidore Cohn, 270 U.S. 339, 345-346. The Act is not limited in its application only to situations where the person guilty of the fraud personally makes the claim against the Government based on the Government's liability to such person. The Act applies where a person's fraudulent conduct causes a claim to be made against the Government, based on the Government's liability to the claimant. The claimant may be an entirely innocent party, the only requirement being that the claim contain an element of fraud. The person who is responsible for that element is liable under the Act. However, the fundamental requirement is that there must be a "claim" within the meaning of the Act.

The appellee neither made nor participated in making a claim against the Government. The proper test for discovering the presence of a "claim" is to determine whether there has been a demand for the transfer of money or property based on the Government's liability to the claimant. A "claim" or "demand" connotes the assertion of a legal right. Thus, the "claim" must be predicated on a legal obligation of the Government to the claimant. The appellee merely participated in an application for a loan. An ap-

plication for a loan is nothing more than a request to enter into a contractual agreement. There was no obligation on the part of the Government to grant the loan. Clearly, this does not meet the requirement of the Act that a "claim" be involved. The Supreme Court has admonished that since we are actually dealing with the provisions of a criminal statute, the words "claim against the Government" must be restricted not only to their literal terms, but to the evident purpose of Congress in using those terms. It is clear that the Act was not designed to reach every kind of fraud practiced on the Government but that it was to be limited to those involving "claims against the Government."

The nature and terms of the loans involved precluded the possibility that they could ever result in a claim being made against the Government. The loans were for a term of four years and carried an interest rate of 4% on the unpaid balance. The security for the loan consisted of a chattel mortgage on the fixture and, if the county committee did not feel that was sufficient, a real estate mortgage on a saleable portion of the borrower's property. The borrower was required to pay an application fee and the filing fees for all security agreements and all mortgages were equipped with acceleration clauses. It was impossible for the Government Treasury to be de-

pleted or for a claim to be made under contracts such as this.

The appellant cites numerous cases in support of its position. However, close examination of the cases reveals that they really support the appellee's position in that they demonstrate that the False Claims Act is applied only where there has been a claim against the Government, as a matter of right, based on the Government's own liability to the claimant. It is clear that the District Court properly evaluated the cases arising under this Act. The only cases disregarded by the Court below either present no precedent as to any of the issues involved here or, in one instance, recite propositions which may be relevant but which are not supported by the authorities cited by the case. This demonstrates that this appeal is based on the Government's incorrect interpretation of both the Act and the District Court's opinion. The facts in this case do not involve a "claim against the Government, as a matter of right, based on the Government's liability to the claimant" and that is a necessary prerequisite for the application of the False Claims Act.

ARGUMENT

"CHAFING AT THE UNIFORM CONSTRUC-TION OF THE STATUTE, THE UNITED STATES IN EFFECT INSISTS THAT THE STATUTE IN FACT AND IN LAW APPLIES HERE WHERE NEITHER MONEY NOR PROPERTY WAS CLAIMED FROM OR AGAINST THE UNITED STATES." United States v. Cochran, 235 F. 2d 131, 133 (5th Cir. 1956).

Introduction:

The only issue presented by this appeal is whether, under the facts as stated in the complaint, it can be stated that the defendant ever participated in making a false claim against the Government or was in any way responsible for inducing the Government to enter into a contract that had the result of subjecting the United States to an enforceable demand for money or property. The appellant has stated the issue in terms that are far too broad. We are not here concerned with the multiple varieties of loan programs administered by the United States Government. We are concerned only with the twelve loans that are set forth in the Complaint and which were obtained under the Farm-Storage Facility Loan Program. The appellant has attempted to portray the opinion of the court below as giving the "green light" to wholesale pilfering of the public treasury. Such portrayal is not only completely unwarranted by the opinion itself, but also has no relevance to the issue at hand. This appeal is concerned only with the Neifert-White Company and whether the loan applications for which they furnished invoices constituted the making of "claims against the Government" which are within the purview of 31 U.S.C. § 231. It is to this issue that we direct our argument.

T

A "CLAIM" WITHIN THE MEANING OF THE FALSE CLAIMS ACT IS A CLAIM FOR MONEY OR PROPERTY TO WHICH A RIGHT IS ASSERTED AGAINST THE GOVERN-MENT, BASED UPON THE GOVERNMENT'S OWN LIABILITY TO THE CLAIMANT.

It is and has been the appellee's contention that the Complaint fails to allege facts that do involve or could possibly involve a claim against the Government within the meaning of the False Claims Act. "In order to bring a case within the statute we have referred to, it is necessary to show that a claim is presented against the United States, or in rem against its property." United States ex rel. Kessler v. Mercur Corp., 83 F. 2d 178, 181 (2d Cir. 1936). This Court has phrased this requirement in the following way: "... [T]he manner in which the fraud occurs is controlling in bringing the False Claims Act into play. To do that, there must be more than mere fraud; the fraud must be predicated on a claim." United States v. Howell, 318 F. 2d 162, 166 (9th Cir. 1963).

The United States Supreme Court has clearly defined what it is that constitutes a "claim" within the meaning of 31 U.S.C. § 231.

While the word "claim" may sometimes be used in the broad juridical sense of a "demand of some matter as of right made by one person upon another, to do or to forbear to do some act or thing as a matter of duty" (Prigg v. Pennsylvania, 16 Pet. 539, 615, 10 L.ed. 1060, 1089), it is clear, in the light of the entire context, that in the present statute, the provision relating to the payment or approval of a "claim upon or against" the government relates solely to the payment or approval of a claim for money or property to which a a right is asserted against the government, based upon the government's own liability to the claimant. United States v. Isidore Cohn, 270 U.S. 339, 345-346, (1926) (Emphasis supplied).

This definition of what it is that constitutes a "claim" within the meaning of the False Claims Act has met with universal acceptance. Indeed, as recently as 1963 this Court specifically adopted this definition as ariginally given, and stated that it had not been changed or altered by *United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943). See, if the Court please, *United States v. Howell, supra*. As pointed out in the opinion below, the Supreme Court found this definition still relevant in *United States v. McNinch*, 365 U.S. 595 (1958) (R. 40). Although numerous other cases have relied on this definition, we deem it sufficient (as did the District Court) to point to *United States v. Tieger*, 234 F. 2d 589 (3rd Cir. 1956) as final con-

firmation of the validity and accuracy of the Cohn definition.

The Appellant has argued that United States ex rel. Marcus v. Hess , supra, "... precluded the district court's reliance on Cohn as a basis for holding that, to be within the Act, a claim must be founded on a legal obligation of the Government." (Brief 10). Appellee does not take the position that the Hess case is incorrect, but we do take the position that the appellant has urged an interpretation of it that is unwarranted by both its language and its facts. The Government asserts that an enforceable demand for money or property, based on the Government's own liability was not involved in the Hess case and that, therefore, it is not necessary for a claim to be predicated on the Government's liability to the claimant. We will discuss the rather curious effect this argument has on the meaning of what it is that constitutes a "claim against the Government" at a later point. For the moment we wish to point out that there was indeed a claim involved in the Hess case and that the claim coincided with the definition given in Cohn.

As stated in appellant's brief, the *Hess* case involved several P.W.A. projects. Although the projects were sponsored by local municipalities, they were funded by the Federal Government and were under constant Federal supervision. The defendants in that

action were contractors who endeavored to insure their success, and a substantial profit margin, through the device of collusive bidding. The bidding resulted in contracts between the individual contractors and the local municipalities. There was no direct contractual relationship between the contractors and the Federal Government, but the contractors knew that the projects were largely financed by it. It is quite clear that the payments to the contractors were claims against the local municipalities for money based on the municipalities' liability to the claimants under the contracts. A demand for such payments, were it not for the fraud involved, would certainly have been enforceable. However, the False Claims Act applies only where the Federal Government has been subjected to a claim for money or property based on its own liability to the Claimant. The Federal Government was certainly under no obligation to fund the projects, nor, as we have pointed out, was it under any contractual obligation to the contractors. However, once it had agreed to fund the project and the work had begun, was it in a position to tell the local sponsors that the Federal Government had decided that it would not fund the projects, and that the local municipalities would have to finance the projects on their own? Without knowing the exact nature of the agreement between the local municipalities and the P.W.A., we

would find it difficult to believe that the Government could have withdrawn its funds and not discovered that it was subject to a claim for money based on its own liability to the claimant (which in this case would have been the local municipality). Furthermore, the amount of the claim would be determined by the bids which were submitted by the contractors. Thus, we see that although the contractors did not themselves make claims against the Government, they were responsible for the claims that were made by the local municipalities in that the latter claims consisted of sums that were fraudulently contracted for through the device of collusive bidding. Therefore, the contractors were subject to liability under the False Claims Act because they "caused to be made" false claims against the Government.

The opinion by the Court below does not say that the False Claims Act applies only where the person guilty of fraud makes a claim against the Government based on the Government's liability to him. The Act itself and the cases make it perfectly clear that it is not necessary that the person guilty of the fraud make the claim against the Government himself or that the Government's liability be to him. (Of course the Act would apply under such conditions). What is required by the Act, the cases and the opinion of the Court below, is that the guilty party cause such a

claim to be made against the Government, based on the Government's own liability, whether that liability be to the guilty party or some entirely innocent third party. Nevertheless, the Act does not apply unless there has been a claim made against the Government, based on the Government's own liability. This is why the Act is known as the False Claims Act.

An excellent example of the application of this rule can be found in United States v. Lagerbusch, 361 F. 2d 449 (3rd Cir. 1966), and from which the appellant takes unwarranted comfort. (Brief, 14-15). Indeed, the incorrect interpretation the appellant places on Lagerbusch brings into sharp focus the fundamental error upon which this appeal is based. Mr. Lagerbusch was apparently the recipient of unearned and undeserved payments as the result of false representations (of some undisclosed nature) which he made to his employer. The employer, Hercules Powder Co., was operating under a cost plus contract "under which the United States paid or reimbursed Hercules for all operating costs, including the sums fraudulently obtained from Hercules by the appellant." Here, the employee did not personally make a direct claim against the Government and the Government was under no liability to him. However, the employee's fraudulent representations caused his employer to make a claim against the Government based on the Govern-

ment's liability to the employer. The claim made by the employer contained an element of fraud (i.e. the undeserved payments caused by the employee's fraud) and that in turn caused a fraudulent claim to be made against the Government, based on the Government's own liability to the claimant (i.e. the employer). This is analogous to what happened in Hess. The contractors made a claim against the local municipalities which in turn made a claim on the Government for the funds it had agreed to supply. Because of the collusive bidding on the part of the contractors, the Government was required to supply a greater amount of money to the local sponsors that it should have. Hess was not decided on the basis of claims made by the contractors against the Government, but rather on the basis of claims against the Government which the contractors caused to be made. This is conclusively shown by the following language of the Court:

The conclusion that the firset clause of §5438 includes this form of "causing to be presented" a "claim upon or against the government" is strengthened by a consideration of the other clauses of the statute. Clause 2 includes those who do the forbidden acts for the purpose of "aiding to obtain" payment of fraudulent claims; Clause 3 covers "any agreement, combination or conspiracy" to defraud the government by "obtaining or aiding to obtain the payment or allowance of any false or fraudulent claim." These

provisions, considered together, indicate a purpose to reach any person who knowingly assisted in causing the government to pay claims which were grounded in fraud ,without regard to whether that person had direct contractual relations with the government. (317 U.S. 537 at 544-545.) (Emphasis supplied).

It is therefore, clear why the Court in Lagerbusch cited Hess and said that there was nothing in Cohn that was inconsistent with their decision. The Cohn definition does not say that the claimant must be the person guilty of the fraud in order to bring the Act into play. Indeed, the terms of the Act itself would preclude such a holding. The fundamental requirement of Cohn, the Act and the cases is that a claim be made against the Government. These authorities also make it clear that no "claim" within the meaning of the Act has been made unless there has been a demand for money or property to which a right is asserted, based on the Government's own liability to the claimant. This has been the uniform interpretation given to the Act.

II.

THE APPELLEE NEITHER MADE NOR PARTICIPATED IN MAKING A CLAIM AGAINST THE GOVERNMENT. THE PROPER TEST FOR THE PRESENCE OF A "CLAIM" IS TO DETERMINE WHETHER THERE HAS BEEN A DEMAND FOR THE

TRANSFER OF MONEY OR PROPERTY BASED ON THE GOVERNMENT'S LIABILITY TO THE CLAIMANT.

If the appellee is to be held liable under the False Clams Act, it must have made a claim against the Government or aided or participated in the making of such a claim. In the interests of clarity we will first consider whether Neifert-White Co. made a claim against the Government and then we will consider whether it participated or aided in the making of such a claim. It is quite clear that the mere filing of an invoice with a governmental agency (and that is all the Complaint accuses the appellee of doing) cannot possibly be construed as making a claim against the United States.

"An invoice", as stated by this court in Dows v. National Exch. Bank of Milwaukee, 91 U.S. 630 (23:217), "is not a bill of sale, nor is it evidence of a sale. It is a mere detailed statement of the nature, quantity, or cost of the goods, or price of the things invoiced, and is as appropriate to a bailment as a sale. Hence, standing alone, it is never regarded as evidence of title." Sturm v. Boker, 150 U.S. 312, 328, (1893).

If an invoice does not constitute evidence of a sale, bill of sale or evidence of title, it could not possibly constitute a claim for money or property within the meaning of the False Claims Act. Therefore, the filing of the invoice, in and of itself, could not subject the defendant to liability under the statute.

This raises the second question which is whether the defendant assisted or participated in making a claim against the United States. In the Complaint, the Government alleges that it was induced to loan sums of money greater than the amount to which the borrowers were entitled because of invoices issued by the appellee. The appellee denies that the county ASC committee in any way relied upon such invoices in approving the loan applications or in executing the subsequent commitments for the loans. However, for the purposes of this motion for judgment on the pleadings, we must assume that the invoices were as integral a part of the loan applications as the Government asserts. The issue that is necessarily raised by this assumption is whether the loan applications could be considered "claims" within the meaning of the False Claims Act. What is the proper way to characterize a loan? The Court below referred to the description given at 54 C.J.S. "Loans", p. 654, (R. 41) where it is stated that:

A loan of money has been defined as a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrows * * * A loan of money is something more than the mere delivery of money by the owner to another. In order to constitute a loan there must be a contract whereby, in substance, one party transfers to the other a sum of money which the other agrees to repay absolutely, together with such additional sums as may be agreed on for its use.

If a loan is a contract, then an application for a loan is a request to enter into a contractual relationship. The Farm-Storage Facility Loan Program was designed to grant the growers of certain commodities the privilege of borrowing money to finance the purchase of storage facilities. ". . .[T]his privilege of contracting certainly is not a claim in normal business or legal usage and terminology." *United States v. Teiger, supra,* at 591. In footnote No. 7 of the *Tieger* opinion, the court made the following observation:

The "claim" must be presented for "payment or approval." This describes the usual procedure in making a demand for money or property but is not an apt characterization of what is done in calling upon another to enter into a contract. *Supra*, at 591.

In the Tieger case, the complaint alleged that the defendant had made false and fraudulent representations on behalf of clients in order to secure FHA "Property Improvement Loans." It was also alleged that the loans were granted in reliance upon the credit applications filed by the defendant, and that the promissory notes, that were executed by the cli-

ents, were negotiated and assigned to the First Bancredit Corporation and that the said promissory notes were accepted by the FHA for insurance "based on a loan report submitted by the First Bancredit Corporation." The defendant moved to dismiss for failure to state a claim upon which relief could be granted under 31 USC §231. In upholding the District Court's order granting the motion to dismiss, the Court of Appeals held that the statute did not cover fraud in inducing a guarantor's promise, the performance of which was conditioned upon an event which never occurred. The court went on to explain that the alleged claim was nothing more than the privilege of a lending institution to unilaterally negotiate a contract under which it would pay a modest sum and receive in return the promise of the Government to make good any default by the borrower. In the case before us, the individual farmers were merely exercising their privilege of negotiating a loan contract with an agency of the Government.

In *United States v. Veneziale*, 268 F. 2d 504 3rd Cir. 1959) a defendant was held liable on substantially the same facts that were present in the *Tieger* case. However, there was one crucial difference between the two situations. In the *Veneziale* case, there was a default and the Government had to make good its guaranty. The court said that the defendant's wrong

was an essential factor in subjecting the Government to an enforceable demand for money. The opinion stated that it was "... [S] ettled that a fraudulently induced contract may create liability under the False Claims Act when that contract later results in payment thereunder by the government, whether to the wrongdoer or someone else." Supra, at 505.

When the above two cases are considered together the law becomes quite clear. Fraudulently inducing the Government to enter into a contract creates no liability under the False Claims Act unless that contract actually subjects the United States to an enforceable demand for money—i.e. a claim. It is the appellee's contention that the contracts to which the Government refers in the Complaint did not and could not have subjected the United States, or any agency thereof, to an enforceable demand for money. At this juncture, we wish to point out that Tieger, Veneziale and Lagerbusch are all from the Third Circuit. These decisions are entirely consistent and, indeed, complement one another. They demonstrate that in the Third Circuit the False Claims Act can not be applied solely on the basis of the presence of fraud. As required by Cohn, the fraud must result in a claim being made against the Government for money or property, and that claim must be based on the Government's liabality to the claimant.

The appellant has taken issue with the lower Court's opinion that United States v. McNinch, 356 U.S. 595 (1958) really supports the defendant-appellee's position. Appellant argues that McNinch was based on the theory that a false application for credit insurance may or may not require the disbursement of federal funds and that, therefore, the proper way to determine whether the False Claims Act applies is to see whether there has been a disbursement of funds. In other words, appellant is arguing that the test for the presence of a claim is whether or not funds are disbursed and not whether a demand for money or property, based on the liability of the Government to the claimant, has been made. This is tantamount to saying that a "claim" within the meaning of the False Claims Act has been made any time the Government actually disburses money or property. We respectfully submit that such an interpretation is entirely inconsistent with the normal understanding of what it means to make a "claim". Indeed, it would effectively remove the requirement that there be a "claim" in order to apply the sanctions of the Act. "If the Act were intended to cover any and all attempts to cheat the United States, we doubt that the Congress would have used the word 'claim' to specify such an intent." United States v. Howell, supra, at 165. Actually, McNinch was decided on the obvious proposition that an application for

credit insurance may or may not result in a claim being made against the Government. In other words the decision is entirely consistent with the Third Circuit's holdings in *Tieger* and *Veneziale*. Thus, the question is whether or not a claim has been made and not whether there has been a disbursement of money. It is quite obvious that it is possible for there to be disbursements where no claims have been made, and for that simple reason, the presence of a disbursement can not possibly be an adequate test for the presence of a claim under the False Claims Act. This Court has refused to rewrite this statute to accommodate the Government in the past and we earnestly request that it refuse to do so now.

An examination of *McNinch* will show that the appellant's position is without precedent in the case law that has developed under the Act. Let us begin by considering a quotation from *McNinch* which is also set out in the appellant's brief. (Brief, 12).

In the normal usage or understanding an application for credit insurance would hardly be thought of as a "claim against the government." As the Court of Appeals for the Third Circuit said in this same context, "the conception of a claim against the government normally connotes a demand for money or for some transfer of public property." United States v. Tieger, 234 F. 2d 589, 591. In agreeing to insure a home improvement loan the FHA disburses no funds nor

does it otherwise suffer immediate financial detriment. It simply contracts, for a premium, to reimburse the lending institution in the event of future default, if any. *United States v. Mc-Ninch, supra*, at 598-599. (Emphasis supplied).

The emphasized statement above must be interpreted in the light of the general rules of grammar. The subject of the sentence is "conception", the predicate is "connotes" and the object is "demand". Thus, the sentence merely says that the conception of a claim against the Government connotes a demand. The question "demand for what?", is answered by the two prepositional phrases (i.e. "for money" and "for some transfer of public property") which modify the object of the sentence, "demand". Therefore, the Mc-Ninch decision follows the Tieger case in saying that there is no claim unless there is a demand for money or for the transfer of public property. The key word is "demand".

In practice, the word "demand" is defined as meaning the assertion of a legal right; the assertion of a right to recover a sum of money a calling for a thing due or claimed to be due; a claim; a peremptory claim to a thing of right a request to pay; a requisition or request to do a particular thing specified under a claim of right on the part of the person requesting; a request addressed to a person that he will do some act which he is legally bound to do, after the request has been made; the right or title in virtue of which any-

thing may be claimed, as to hold a demand against a person; also a legal obligation; a thing or amount claimed to be due and in a particular context the word has been construed as meaning notice requiring surrender of possession. 26A C.J.S. "Demand" p. 169. (Emphasis supplied).

Black's Law Dictionary (4th ed. 1951) gives the following definitions of "demand":

The assertion of a legal right; a legal obligation asserted in the courts; a word of art of an extent greater in its significance than any other word except "claim", . . .

A debt or amount due . . .

An imperative request preferred by one person to another, under a claim of right, requiring the latter to do or yield something or to abstain from some act . . . (emphasis supplied).

Consequently, it is quite clear that *McNinch* and *Tieger* are quite consistent with *Cohn*. One can not be said to make a demand upon the Government unless the request which constitutes the demand is based on an obligation on the part of the Government to comply. This is necessarily so because if there were no obligation on the part of the Government, the request would be a mere naked request and could hardly be termed a demand. If the court felt that a mere naked request, not based on any obligation of the Government, was sufficient, then it is rather difficult to understand why it used the word "demand". The landard the contraction of the court felt that a mere naked request and why it used the word "demand".

guage of the Act and the cases lead inevitably to but one conclusion. The False Claims Act does not apply unless there has been a claim made against the United States and such a claim is not made unless there has been a demand for money or property based on the Government's liability to the claimant.

III.

THE TERMS OF THE FALSE CLAIMS ACT MUST BE STRICTLY CONSTRUED, AND IT MUST BE APPLIED IN A MANNER THAT IS CONSISTENT WITH THE PURPOSES CONGRESS HAD IN ENACTING IT.

The United States Supreme Court has been very explicit in stating what policy is to be followed in deciding whether a claim has been made against the Government.

We acknowledge the force of the Government's argument that literally such an application could be regarded as a claim, in the sense that the applicant asserts a right or privilege to draw upon the Government's credit. But it must be kept in mind, as we explained in Rainwater, that in determining the meaning of the words "claim against the Government" we are actually construing the provisions of a criminal statute. Such provisions must be carefully restricted, not only to their literal terms but to the evident purpose of Congress in using those terms, particularly where they are broad and susceptible to numerous

definitions... Citing United States ex rel. Marcus v. Hess, 317 U.S. 537, 542.)

The False Claims Act was originally adopted following a series of sensational congressional investigations into the sale of provisions and munitions to the War Department. Testimony before Congress painted a sordid picture of how the United States had been billed for nonexistent or worthless goods, charged exhorbitant prices for goods delivered, and generally robbed in purchasing the necessities of war. Congress wanted to stop this plundering of the public treasury. At the same time it is equally clear that the False Claims Act was not designed to reach every kind of fraud practiced on the Government. From the language of the Act, read as a whole in the light of normal usage and the available legislative history we are led to the conclusion that an application for credit insurance does not fairly come within the scope that Congress intended the Act to have. United States v. McNinch, supra, 356 U.S. 595 at 598-599. (Emphasis supplied).

It is the appellee's position that filing an application for a loan does not come within the intent of the Act either, particularly under the circumstances in which these loan applications were filed. The Supreme Court has emphasized that the terms of the Act, and especially the words "claim against the Government" are to be strictly limited to the evident purpose of Congress in using those terms. This is a particularly relevant admonishment here, as the potential penalty

is very great when compared to the magnitude of the alleged wrong of the defendant-appellee. This also seems to be an opportune time to point out that the first portion of the above quotation from *McNinch* utterly refutes the argument of the appellant that, "... with few (if any) exceptions no individual has any more of an enforceable right to a grant-in-aid from the Federal Government than he does to a loan of public monies." (Brief, 6). On the preceeding page (Brief, 5) the appellant admitted that there was no legal obligation on the part of the United States to approve the grain grower's applications for loans.

Footnote No. 9 of the *McNinch* decision contains the following background on the False Claims Act and provides valuable insight into the type of situation Congress was trying to remedy.

The manager of the bill in the Senate stated as follows:

"I will simply say to the Senate that this bill has been prepared at the urgent solicitation of the officers who are connected with the administration of the War Department and Treasury Department. The country, as we know, has been full of complaints respecting the frauds and corruptions practiced in obtaining pay from the Government during the present war; and it is said, and earnestly urged upon our attention, that further legislation is pressingly necessary to prevent this great evil; and I suppose there can be

no doubt that these complaints are, in the main, well founded. From the attention I have been able to give the subject, I am satisfied that more stringent provisions are required for the purpose of punishing and preventing these frauds; and with a view to apply a more speedy and vigorous remedy in cases of this kind the present bill has been prepared." Cong. Globe, 37th Cong., 3rd Sess. 952.

Apparently there were no committee reports nor any record of the proceedings in the House.

—This footnote appears at 356 U.S. 595, 599. (Emphasis supplied).

IV.

THE VERY NATURE OF THE LOANS IN-VOLVED PRECLUDED THE POSSIBILITY OF THEIR PROVIDING A BASIS FOR A CLAIM AGAINST THE GOVERNMENT.

Let us now examine the loan applications and contracts that are involved in this case. The terms of these contracts are clearly set forth in the Farm-Storage Facility Loan Program Regulations which can be found at 23 Federal Register 5029 (July 2, 1958). The loans were made for a term of four years. The interest rate on the loans was 4% per annum on the unpaid balance.

Loans will be secured (1) by chattel mortgage on the storage facility, which shall constitute the sole lien on such facility, or (2) by a first lien in the form of a real estate mortgage, deed or trust, or other security instrument, approved by CCC, on the borrower's farm or other property on which the facility is to be located, or on such acreage of the farm as will, in the judgment of the county committee, (i) make the site easily accessible for use of other farmers in the area, and (ii) constitute a saleable unit. A first lien on real estate will be required in connection with all loans relating to immovable facilities, and may be reguired in connection with any other loan at the discretion of the person authorized by CCC to approve the loan, . . . In case of chattel mortgage loans, a severance agreement must be executed and acknowledged by all persons having an interest in the land on which the structure will be placed, . . . The cost of recording or filing all documents required in connection with the loan shall be paid by the borrower . . . Every application for a farm storage facility loan secured by a chattel mortgage shall be accompanied by an instrument, duly acknowledged for recording purposes, under which the owner of the premises on which the facility is to be located consents that if the farm storage facility is acquired by CCC through foreclosure or other means, such facility may, at the option of CCC, remain on the property for a period not to exceed six months at no expense to CCC . . .

Each installment must be paid out of price support proceeds, in cash, or otherwise not later than the end of the applicable twelve months pay period, and *upon failure to pay any installment* by the thirtieth day after the end of such period *the*

loan may be declared delinquent and at the option of the county committee upon authorization of the State Committee the loan may be called and the entire unpaid amount of the loan shall become immediately due and payable. FARM-STORAGE FACILITY LOAN PROGRAM REGULATIONS, §474.725. (Emphasis supplied).

It is very apparent that the Government has provided very well for its own interests. One very significant point is that the Government is not limited to the facility itself for security for its loan. Indeed, if the county committee feels that the storage facility is not of sufficient value to cover the amount of the loan, it can require additional security in the form of a real estate mortgage on a plot of real estate of sufficient value to make up whatever deficit the committee deems necessary. Obviously, the committee is thus required to make some estimate of the value of the facility in order to determine whether or not a real estate mortgage will be required in addition to the chattel mortgage on the facility. It is also significant that §474.727 of the Regulations requires that the constructed facility be inspected by a designated employee of the county committee or the committee itself before actual disbursement of the loan takes place.

It is the appellee's contention that under this type of contract the Government could never be subjected to an enforceable claim for money based on its own liability, even if the loans had been defaulted (which is not the case here). On the contrary, when the Government finally made disbursements for the loans involved here it received in return chattle and/or real estate mortgages which it had determined to be of sufficient value to prevent any loss in case the repayments were defaulted. Thus, under the transactions here involved, it was virtually impossible for the United States Treasury to be depleted, because, when it disbursed the loan it received security in the form of mortgages which it had determined to be of equal value to the disbursement. It is to be noted that the Complaint contains no allegation that any of the loans were ever defaulted. The reason they contain no such allegation is because none of the loans were defaulted. It is incredible that the Government can seriously contend that it was in any way financially disadvantaged by the application for, or the awarding of, these loans, particularly where every one was paid in full, complete with interest. As far as the terms of the loans being superior to those obtainable from commercial sources, we can only say that we would be interested in knowing what safety devices commercial lending institutions use that the Government did not provide for in these cases. It is true

that the 4% interest charged by the Government is somewhat less than the commercial rates, but this does not mean that the Government was disadvantaged thereby. Indeed, it could not be said that the Government was disadvantaged in any sense unless it could be said that had they not loaned the money to the borrowers at 4% they could have loaned it elsewhere at a higher rate. Since the Government has not, to our knowledge, begun to compete in the commercial banking buiness, we doubt that it could or would have loaned its money elsewhere at higher interest rates. This interest differential could thus be deemed a subsidy only in the broadest possible sense of the word. Surely it is much less a subsidy than farm price-support payments as it involves no out-ofpocket expenditure by the Government.

V.

THE REMAINDER OF THE CASES CITED BY THE APPELLANT DO NOT CONFLICT WITH THE OPINION OF THE DISTRICT COURT BELOW, BUT RATHER, ARE IN HARMONY WITH IT.

There remain several cases cited in the appellant's brief that we have not yet discussed. We will begin with *United States v. Alperstein*, 183 F. Supp. 548 (S.D. Fla. 1960), affirmed, 291 F. 2d 455 (5th Cir. 1961). The appellant states at page 15 of its

brief that, "While a veteran does not have a legally enforceable right to treatment for a non-service connected disability in a VA institution, he may be given such treatment on a space-available basis if he is financially unable to pay the necessary expenses of hospital care." (Emphasis supplied). We find this statement impossible to reconcile with the following statement found at page 550 of the Alperstein case:

The statute is mandatory in terms, leaving no discretion to the Administrator of Veterans Affairs or to his designates or subordinates as to the admission or rejection of applicants. It establishes a simple standard of eligibility and evidence of qualification, which, when met, automatically precludes the Veterans Administration from refusing to provide the applicant with hospitalization. When the applicant proves that he is an otherwise eligible veteran, and when he states that he is unable to defray the cost of hospitalization, the Veterans Administration has no choice other than to admit him and to treat him. United States v. Petrik, D.C. Kan., 154 F. Supp. 598. (Emphasis supplied).

It is thus apparent that the *Alperstein Court* was definitely of the opinion that Mr. Alperstein had a legally enforceable right to be admitted to the VA hospital. Actually, the only real question in *Alperstein* was whether the claim for hospital care constituted a claim for "money or property" within the meaning of the Act. In holding that such a claim was within the Act

the Court said that a claim for services depletes the treasury in the same manner as would a claim for money or property. For our purposes, the crucial point is that the *Alperstein* case does not stand for the proposition that there can be a "claim" against the Government where there is not an enforceable claim for money or property based on the Government's liability to the claimant. In short, the "claim" in *Alperstein* meets all the requirements of the *Cohn* definition.

Appellant also cites *Smith v. United States*, 287 F. 2d 299 (5th Cir. 1961), as a holding directly contrary to the ruling below in this case. Mr. Smith was the Executive Director of the Beaumont Housing Authority (BHA). BHA was the lessee of a housing project owned by the Federal Government.

Under the lease BHA agreed to pay as rental the amount by which operating revenues exceeded approved expenses for the preceding quarter. Under other provisions the Government agreed to advance funds to cover operating deficits. Quarterly reports had to be filed by the lessee reflecting the amount due to, or due by, the Government depending on whether operations reflected a surplus or a deficit for that quarter. Supra, at 300.

Because of Mr. Smith's fraudulent conduct, the operating costs exceeded the income on the quarterly re-

port, and the resulting deficit required the Government to advance funds under the contract with BHA. Clearly, there was no Governmental liability to Mr. Smith. However, there was contractual liability between the Government and BHA. The Court said:

So far what we have said may have given the impression that the false claims were the signing, delivering and cashing of the checks. This is not the case. That discussion was to demonstrate the permissible basis for the Court's conclusion that the underlying transactions were a fraud. The false claims arose because Smith, as Executive Director, knowing the true facts to be otherwise signed the quarterly reports which included these disbursements as allowable expenses. No Federal money as such was paid to or received by Smith, Celestine or the "double timing" employee. The Federal Treasury suffered because BHA, having made the disbursements, got them back from the Federal Government either as an outright payment, or as a deduction of like amount what otherwise would have been remitted by BHA as rental. Supra, 303-304.

Thus, Mr. Smith's fraud did result in a claim being made against the Government for money based on the Government's liability under its contract with the claimant (BHA). The above quote indicates that the Court was of the opinion that Mr. Smith would have been subject to the Act even if a deficit had not resulted and the only effect of his fraud would have

been to reduce the amount of rent paid to the Government. Clearly, the Court could not embrace such an opinion if it thought that the proper test for the application of the False Claims Act was whether or not funds had been disbursed.

Of Sell v. United States, 336 F. 2d 467 (10th Cir. 1964) the appellant says, "This holding, too, would not have been possible had the Act been read as requiring that the claim 'be founded as of right upon the Government's own liability to the claimant." (Brief, 17). On page 474 of the opinion, the Court says otherwise.

In the instant case, unlike the Borth case, the purpose of the claim was to obtain property. The purchase Orders received by Sell as the result of his application were fully negotiable through any authorized feed dealer and were valuable items of property which, upon issuance, caused the Commodity Credit Corporation to "suffer immediate financial detriment," in that it became liable to redeem such Purchase Orders for Dealer Certificates, which, in turn, were redeemable for grain owned by Commodity Credit Corporation. (Emphasis supplied).

Sell's fraudulent representations caused the CCC to issue Negotiable Purchase Orders to him. Since these purchase orders were fully negotiable, the Government became liable to whomever presented them for Government owned grain. Had it not been for the fraud

of Sell, the Government would not have been liable for the Purchase Orders he caused them to issue. Clearly, this case involved a claim against the Government based on its liability to the claimant (i.e. the holder of the Purchase Orders).

Also cited by appellant is *United States v. DeWitt*, 265 F. 2d 393, (5th Cir. 1959). The defendant was a real estate dealer who was found subject to the penalties provided in the False Claims Act. Here some 29 veterans had applied for home loans through the Veterans Administration. One of the conditions for the disbursement of the loans was that the veteran intended to occupy the home as his residence. In each of the 29 cases the veteran decided not to occupy the home at some time after the loan commitment had been issued and before the final sale and disbursement of the loan. The defendant, who was the dealer in each case, agreed to repurchase the home from the veteran as soon as the transaction was complete. In other words, the veteran bought and sold the home in a few minutes time. In the meantime, the dealer represented to the lending institution that all was in order and that the loan should be disbursed. It was apparently established that at the time this representation was made to the lending institution the defendant knew that the veteran did not intend to occupy the home. Under the legislation existing at that time,

a gratuity of about \$160 was paid by the Government to the lending institution to be credited to the veterans account, at the time the loan was disbursed. Since the loan commitment had already been issued and the veteran's eligibility determined, the Government was obligated to pay the \$160 gratuity when the dealer represented to the lending institution that the transaction had been completed, that it met all the requiremens, and that the loan should be disbursed. The fraud lay in the fact that the dealer knew that the veteran did not intend to occupy the house and that the veteran was, therefore, not entitled to the loan or to the gratuity. Clearly, the dealer had caused a claim to be made against the Government that was within the meaning of the term "claim" as defined by Cohn. Once the veteran's eligibility had been determined, he had an enforceable right to the Government's guaranty and to the payment of the gratuity, provided he intended to occupy the home. Therefore, the dealer's representation to the lender that the veteran intended to occupy the home constituted a false claim, because, had it been true, the Government was bound by legislation to pay the gratuity.

The appellant urges that the District Court improperly dismissed *United States v. Rainwater*, 244 F. 2d 27 (8th Cir. 1957), affirmed 356 U.S. 590. The appellant concedes that the only question decided by

the Supreme Court was whether a claim against the Commodity Credit Corporation was a claim against the Government, but urged that the Circuit Court decided something more, i.e. that the loans on cotton were false claims within the meaning of the False Claims Act. We do not agree that the Circuit Court decided that second question.

The briefs and arguments of counsel are confined to two propositions: *One*, do false claims submitted to wholly owned government corporations, such as Commodity Credit Corporation, come within the purview of the False Claims Act as claims "against the Government of the United States, or any department or officer thereof"? *Two*, do the complaints state facts upon which relief may be granted where there has been no specific allegation of damage? *Supra*, at 28. (Emphasis supplied).

All the second issue was concerned with was whether it was necessary for the complaint to set forth specific allegations of damages which were allegedly caused by the misconduct of the defendant. Clearly, the court could (and did) confront both of the above propositions without ever considering whether or not an application for a cotton producers' loan constituted the making of a claim against the Government.

The appellant may argue that since the case did involve loans on cotton, a loan application must con-

stitute a claim against the Government within the meaning of the Act, since the defendants were indeed found liable. A similar argument could be made on the basis of Toepleman v. United States, 263 F. 2d 697 (4th Cir. 1959), and the answer we give to Toepleman applies with equal force to Rainwater. The decisions that were written with regard to Toepleman do not give a very clear picture of exactly what the facts of the case were. Apparently, the action was based on 82 fraudulent promissory notes that accompanied an application for a cotton producer's loan from the CCC. The fraud was in representing that the cotton had been produced by the makers of the notes when, in fact, it had not been. Forty-three of the notes were defaulted and the cotton which was to secure the loan was not of sufficient value to cover the amount of the defaulted notes. In short, the Government's loan was secured by non-existent property. In searching the opinions handed down on this case we do not find any discussion of the question as to whether or not a "claim against the Government" was involved. Indeed, all of the decisions are concerned solely with the question as to whether a claim against the CCC is tantamount to making a claim against the United States. The final decision was that it was, and in this we willingly concur. However, we do not agree that this case (or Rainwater) presents any precedent for arguing what it is that constitutes a claim against the

Government. It is possible that the issue involving the presence of a "claim" was not even raised, let alone decided. Even if it was decided, the opinions (in both Toepleman and Rainwater) give no clue as to the reasons for such decision, or the meaning that was attached to the words "claim against the Government" by the court in making that decision. Indeed, if the defendants' counsel had raised the question of the presence of a "claim", it would seem that some mention of it would have appeared in at least one of the opinions. In short, these cases are the weakest possible precedent for the proposition that a claim was involved here, and in order to follow it, this court would have to ignore the vast majority of cases that have given meaning and content to the phrase "claim against the Government" in favor of an unknown and undefined position that has no basis in legal or commercial usage and understanding. Therefore, the appellee respectfully submits that neither of these cases (Toepleman or Rainwater) is in point.

We come now to *United States v. Cherokee Implement Company*, 216 F. Supp. 374 (DC Iowa, 1963). We agree that the factual situations in this case and *Cherokee* are analogous, but we urge the Court to examine the case very closely before deciding on its worth as a precedent for the action involved here. On pages 25 and 26 of the appellant's brief there appears

a statement as to what the Cherokee case considers to be the proper test as to whether a claim has been made against the Government. The Court starts out by giving an accurate statement of the definition of a test for the presence of a "claim againest the Government" as found in McNinch, but then goes on to say that "Where the United States actually makes a loan by reason of a false application, there may be a claim under the false claims statute." (emphasis supplied). For this proposition, the court cites United States v. Rainwater, supra. As we have pointed out, we fail to find any support for this proposition in Rainwater and it would seem sufficient to say that if the case does contain any comment or innuendo to this effect it its purely dicta because neither the Circuit Court nor the Supreme Court based their decisions on this issue

The *Cherokee* Court's obvious confusion as to what was involved in the issue before it is demonstrated in the following statement made at page 375 of the opinion:

In United States v. Veneziale, 268 F. 2d 504 (3rd Cir. 1959), it was considered a false claim when the Government had to pay on a loan guaranteed. In all these cases where money was actually paid out in response to a false application for a loan, it was a claim within 31 U.S.C.A. §231, Smith v. United States, 287 F. 2d 299 (5th Cir. 1961); United States v. Brown, 274 F. 2d 107

(4th Cir. 1960); United States v. Globe Remodeling Co., Inc., D.C. 196 F. Supp. 652.

The appellant asserts that the Court below brushed this case aside because none of the cases cited involved loan applications. We wish to assert that the reason the Court below brushed this case aside is that the cases which it cites do not support the propositions for which they are cited. We have already pointed out that the Smith case did not involve a loan and that the case did involve a claim based on the Government's liability to the claimant. Furthermore, the Smith case indicated that Mr Smith would have been liable even if his fraud had not caused a disbursement of money but would have reduced the amount of rent payable to the Government. The Brown case involved a defedant who had planted more tobacco than his acreage allotment allowed. Excess crops were ordinarily marketed at a penalty and were not eligible for price supports. The CCC had authorized a local cooperative to pay prices up to the support level for crops that were harvested within the allotment. The defendant marketed his excess crop in conjunction with a neighbor who had not harvested an amount equal to his quota under the neighbor's "Within Quota" card. They were paid support prices for the excess by the cooperative, which in turn was subsidized by the CCC. The cooperative could not have refused to pay support prices on any crop that was within the grower's acreage allotment, just as the CCC could not have refused to reimburse the cooperative for the support prices it paid. The farmers did not make a claim directly against the Government. However, because of the false representation they did make, the cooperative innocently mad a claim against the Government for a larger subsidy than the Government should have been required to pay. The "claim" was based on the Government's liability to the cooperative.

How Brown could possibly be cited as authority for the proposition that "where money was actually paid out in response to a false application for a loan, it was a claim within 31 U.S.C.A. §231" is beyond comprehension. The difference between a price support payment and a loan is such that it would seem to be impossible to confuse them. The Globe Remodeling case is similar to the Veneziale case and is not authority for the proposition for which it is cited for the very obvious reason that it involved Governmental liability on an insured loan. The Cherokee case involved a loan to cover the purchase price of mobile drying equipment, while Veneziale involved a guarantor's payment by the Government on a defaulted FHA insured loan. The Brown case involved the fraudulent collection of crop price supports by a farmer not entitled to receive them. How a court could equate these situations is difficult to understand. It would seem that the only common element was that in Veneziale,

Smith, Globe Remodeling and Brown the Government suffered financial detriment as the result of claims that had been made against it as matters of right. There was no hope or expectation of repayment. Indeed, there was no obligation to repay; the Government had been separated from its money and had received nothing in return. But in Cherokee the Government had merely loaned some money. In other words, it had disbursed a sum of money with the hope, expectation and contract right of having it returned. The loan was also probably secured by a chattel mortgage on the drying equipment. In this situation, when the Government parted with its money it received something of equal value in return.

In addition, it should be pointed out that the Cherokee case did not say that a claim was involved, it merely said that a claim may be involved. The written opinion did not decide the issue. Instead, the court proceeded with the trial and heard evidence on the matter. Since the case was never appealed, the outcome remains unknown. Therefore, in addition to being poorly reasoned and making fundamental errors in the law, the case presents very weak authority for the appellant's point of view because it did not really resolve the question as to whether or not a claim was involved. Thus, it is not surprising that the court below dismissed Cherokee as not convincing. We are surprised that the Government is convinced by it.

CONCLUSION

We respectfully redirect the Court's attention to the definition of "claim against the Government" as given in the Cohn case. Cohn correctly stated the proper test for the application of the False Claims Act when it was written and this test continues to be entirely valid today. By bringing this action and this appeal the Government has tried to expand the terms of the Act far beyond the original scope of Congressional intent. The False Claims Act applies only where a "claim" has been made against the Government. As we have pointed out above, no such "claim" has been made here. The defendant has been forced to bear the burden of defending these actions because of the Government's reckless disregard for the clear meaning of the Act and the pronouncements of the cases that have construed it. For these and all of the above reasons, the defendant-appellee respectfully requests the Court to sustain the decision of the District Court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

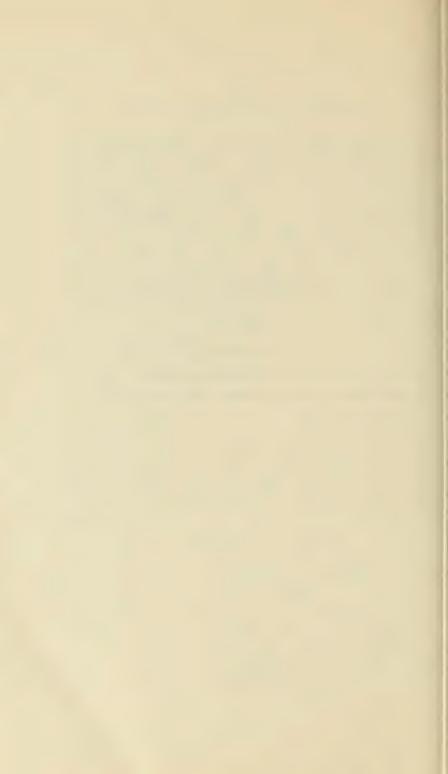
I certify that, in connection with the praparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

V.

NEIFERT-WHITE CO.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

REPLY BRIEF FOR THE UNITED STATES

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IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 20,945

UNITED STATES OF AMERICA,

Appellant,

V.

NEIFERT-WHITE CO.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

REPLY BRIEF FOR THE UNITED STATES

The single ultimate question presented by this appeal is whether the coverage of the False Claims Act extends to a false application for a Commodity Credit Corporation farm storage facility loan, as a result of which application federal monies are transferred to an individual who has no entitlement to them. Dismissing the government's complaint on the ground that the Act did not apply to the loan applications hereinvolved, the district court relied exclusively on the fact that the applications "were not claims * * * for money to which the corrowers were asserting a right based on some liability of the government to the borrowers" (R. 41). This reliance stemmed

from the court's expressed belief that "in order for there to be a claim within the meaning of the False Claims Act, the claim must be founded as of right upon the government's own liability to the claimant" (R. 41).

In Point I of our main brief, we first pointed out (pp. 5-8) that the acceptance of this narrow reading of the Act would open the doors wide to those who would seek to obtain by deception public monies for which they do not qualify. We then demonstrated (pp. 8-20) that the district court's interpretation cannot be reconciled with either the Supreme Court's landmark decision in United States ex rel Marcus v. Hess, 317 U.S. 537 or the decisions of the at least five different court of appeals which have imposed False Claims Act liability in situations where the false claim was not based upon an asserted legal obligation of the government running to the claimant. Finally, we showed (pp. 20-27) that, properly construed, the False Claims Act plainly extends to loan applications which, as those in the present case, fraudulently induce the United States or an agency thereof, to transfer federal funds to persons having no right -- legally enforceable or otherwise -- to their receipt.

We find nothing in appellee's brief which militates against the force of our position. Nevertheless, we think a consideration of some of the specific arguments made by appelled will serve to bring the error of the holding below into sharper focus.

1. Appellee commences its argument (Br. pp. 4-5) with a quotation from United States v. Cochran, 235 F. 2d 131, 133 (C.A. 5), certiorari denied, 352 U.S. 941, which is entirely inapposite here. In Cochran, as in United States v. McNinch, 356 U.S. 595 and United States v. Tieger, 234 F. 2d 589 (C.A. 3), certiorari denied, 352 U.S. 941, the question was whether an application submitted to the Federal Housing Administration for credit insurance in connection with a home improvement loan was a "claim" within the meaning of the False Claims Act. Unlike the loan applications hereinvolved, an application for credit insurance does not, of itself, call for the disbursement of federal funds or the transfer of federal property. The Fifth Circuit simply was giving recognition to this fact when it observed in Cochran that "neither money nor property was claimed from or against the United States."

Equally misplaced is appellee's reliance (Br. pp. 20-23) upon the Supreme Court's quotation in McNinch (356 U.S. at 599) of the Third Circuit's statement in Tieger that "the conception of a claim against the government normally connotes a demand for money or for some transfer of public property." Focusing its attention completely on the word "demand," appellee endeavors to translate this statement into a holding by the Supreme Court that to be within the False Claims Act, a claim must be founded on a legally enforceable right.

It is clear, however, that the Supreme Court did not understand the Third Circuit to have employed "demand" in the very restrictive sense suggested by appellee. In the very next sentence in the McNinch opinion, the Court gave its reason for concluding that an application for credit insurance did not come within the Tieger concept of a "claim. Even though, from the standpoint of amounting to the assertion of a legal right, an application for credit insurance addressed to the FHA is no different than an application for a farm storage facility loan addressed to the C.C.C., the Supreme Court did not find the former to be outside the coverage of the False Claims Act because it was not a "demand." Rather, the critical consideration, in the Supreme Court's own words, was that "[i]n agreeing to insure a home improvement loan the FHA disburses no funds nor does it otherwise suffer immediate financial detriment." 356 U.S. at 599

We stress again that, in this respect, the loan application hereinvolved <u>are</u> markedly different from an application for credit insurance. In agreeing to make a farm storage facility loan, the C.C.C. <u>does</u> disburse funds and, as pointed out in our main brief (pp. 8, 24) does suffer immediate financial detriment

2. While neither the precise holding nor the rationale of McNinch thus lends support to the interpretation given the False Claims Act by the court below, the Supreme Court's decision United States ex rel Marcus v. Hess, supra, cuts directly against that interpretation. Without rehearing the discussion

of the <u>Hess</u> decision contained in our main brief (pp. 10-12), we wish to note that there is a total lack of substance to appellee's attempted distinction of it.

Appellee expressly concedes (Br. p. 9) that the defendant contractors in Hess had no contractual relationship whatsoever with the United States and, further, that "[t]he Federal Government was certainly under no obligation to fund the projects" in connection with which the defendants had submitted collusive bids to the sponsoring local municipalities. It contends, however, that the municipalities possessed legally enforceable claims against the government and that the contractor were held liable under the False Claims Act because their conduct had caused these claims to be false.

For present purposes, there is no need to consider the correctness of appellee's characterization of the municipalities' claims as being founded on an enforceable governmental liability. For, in any case, appellee's theory respecting the basis of the Hess decision has no foundation in the Supreme Court's opinion itself. On the contrary, the Hess opinion makes it perfectly clear that the basis of the imposition of liability upon the contractors was not that, even though the contractors could not assert a legally enforceable right against the United States, the municipalities could.

That the conduct of the contractors' came "well within the prohibition of the" False Claims Act, the Supreme Court stated, could "best be seen upon consideration of the exact nature of [the contractors'] relation to the government." 317 U.S. 542. Continuing, the Court pointed out that, while the contracts induced by the contractors' fraud were made between the contractors and the municipalities and "payment itself, in the sense of the direct transferring of checks, was done in the name of local authorities", at the same time (1) a larg portion of the money paid to the contractors was "federal in origin"; (2) the bidding itself was a federal requirement; and (3) the contractors were fully aware of the Federal Government role in the projects (317 U.S. at 542-543). These factors, in the Court's view, were enough (317 U.S. at 544):

Government money is as truly expended whether by checks drawn directly against the Treasury to the ultimate recipient or by grants in aid to states. While at the time of the passage of the original 1863 Act, federal aid to states consisted primarily of land grants, in subsequent years the state aid program has grown so that in 1941 approximately 10% of all federal money was distributed in this form. These funds are as much in need of protection from fraudulent claims as any other federal money, and the statute does not make the extent of their safeguard dependent upon the bookkeeping devices used for their distribution. The Senatorial sponsor of this bill broadly asserted that its object was to provide protection against those who would "cheat the United States." The fraud here could not have been any more of an effort to cheat the United States if there had been no state intermediary.

The teaching of <u>Hess</u> is thus plain: what is important for False Claims Act purposes is not the precise legal relationship between the government and the claimant but rather whether, whatever may be that relationship, the

defendant has fraudulently occasioned -- either directly or indirectly -- the disbursement of government money or the transfer of government property. In the context of this case, to paraphrase the Supreme Court's statement in Hess, government money is as truly expended whether by grants-in-aid to states or by checks drawn directly against the Treasury to the ultimate recipient in response to an application for a low interest loan. In neither case is the expenditure based upon an assertion by the recipient of a legally enforceable right. But, in both cases, the False Claims Act reaches those who have induced the expenditure by their fraud.

3. At page 26 of our main brief, we noted that the district court had failed to cite a single decision in which the term "claim" was held not to extend to an application which had as its purpose or effect the disbursement of federal monies. The same may now be said for appellee's brief. Not one of the cases upon which appellee relies involved such a disbursement. More importantly, appellee's research -- as ours -- has apparently disclosed no case involving a disbursement of government funds in which the court attached any significance to whether the disbursement had -- or had not -- been based upon a claim of a legally enforceable right against the government.

In our main brief, however, we discussed (pp. 13-18) the several court of appeals decisions, involving the disbursement of federal funds, in which the False Claims Act was held applicable

notwithstanding the fact that the claim was not based "on some liability of the Government to the [claimants]" (R. 42). While we think that those decisions speak for themselves, the tenuousness of appellee's attempted distinction of them is well illustrated by its treatment of Sell v. United States, 336 F. 2 467 (C.A. 10) and United States v. Alperstein, 183 F. Supp. 548 (S.D. Fla.), affirmed, 291 F. 2d 455 (C.A. 5).

Sell, it will be recalled, involved the submission by a farmer of false applications for assistance (in the form of surplus grains) under the C.C.C. 1955 Emergency Grain Feed Progr Noting Sell's contention that applications for assistance under that program do not come within the purview of the False Claims Act, the Tenth Circuit expressed its disagreement, being "of the opinion that Sell's application of January 1, 1956, was a 'claim' as contemplated by the Act." 336 F. 2d at 474.

Appellee does not, of course, contend that Sell's applicate was, itself, "founded as of right upon the government's own liability to [Sell]." It points out, however, that, as a result of his application, Sell was given negotiable Purchase Orders. It then reasons (Br. pp. 34-35) that "[s]ince these purchase orders were fully negotiable, the Government became liable to whomever presented them for Government owned grain. Had it not been for the fraud of Sell, the Government would not have been liable for the Purchase Orders he caused them to issue. Clearly this case involved a claim against the Government based on its liability to the claimant (i.e. the holder of the Purchase Orders).

It would be a sufficient answer to this analysis that appellee is attempting to rewrite the Tenth Circuit's decision in Sell. In terms, the Tenth Circuit held Sell's application — and not the Purchase Orders — to be the claim. And it follows that Sell — and not the persons to whom the Purchase Orders were negotiated — was regarded by the court as the "claimant."

But there is a greater difficulty inherent in appellee's

line of reasoning: under appellee's own theory as to why False Claims Act liability was appropriately imposed in Sell, there is similarly False Claims Act liability here. Upon his fraudulent application for emergency grain feed assistance, Sell obtained negotiable Purchase Orders; upon the fraudulent applications for loans hereinvolved, the farmers obtained negotiable checks drawn upon the Treasury of the United States. To paraphrase appellee's statement regarding Sell: "since these [checks] were fully negotiable, the Government became liable to whomever presented them for [payment]. Had it not been for the fraud of [appellee] the Government would not have been liable for the [checks] [appellee] caused [it] to issue. Clearly, this case involve[s] a claim against the Government based on its own liability to the claimant (i.e. the holder of the Treasury checks)

We hasten to stress that, notwithstanding appellee's invitation, we do not ask this Court to reverse the judgment below by holding (following appellee's reasoning) that a loan application involves a claim against the government which is based on its liability to the claimant. In our view, there can be no

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question that here (as in <u>Sell</u>) the "claim" for False Claims

Act purposes was the application, and the "claimant" the

individual who submitted that application. We think it

significant, however, that, in its attempt to defend its

construction of the False Claims Act, appellee has been compelled to resort to an analysis which is both sophistic and selfdefeating.

The untenability of appellee's restrictive interpretation of the Act is further underscored by its discussion of Alperster v. United States, supra, involving a veteran's false application for treatment in a V.A. Hospital of a non-service connected disability. While appellee seems to accept the correctness of the Alperstein holding that the False Claims Act applies to such an application, it argues (Br. pp. 31-32) that the basis of that holding was that a veteran has a legally enforceable right to admission to a V.A. Hospital so long as he meets the eligibility requirements.

We do not think that appellee's quotation (Br. p. 31) from the opinion of the district court in Alperstein supports that conclusion. Taken in context, it seems obvious that the court was simply referring to the statutory requirement that "[t]he statement under oath of the applicant * * * shall be accepted as sufficient evidence of inability to defray necessary expenses" (emphasis that of the Court; 183 F. Supp. at 550). That the statute, even in its then form (see 38 U.S.C. (1952 ed. 706) did not place the V.A. under a mandatory duty to give

nospital care to all eligible applicants is manifest from the qualification that the furnishing of such care was to be "within the limitations existing in such facilities."

In short, we do not believe that the Alperstein decision can be fairly read as resting upon the proposition that, by reason of 38 U.S.C. (1952 ed.) 706, the United States had a legally enforceable obligation to admit Alperstein for treatment (the breach of which would have subjected the United States to a suit to compel admission or for damages). But even assuming that Section 706 had such effect, there can be no question that 38 U.S.C. 610(a) -- which superseded Section 706 in 1958 -- does not. Section 610(a) provides that the Veterans Administrato "within the limitation of Veterans' Administration facilities, may furnish hospital care which he determines is needed to a veteran with a non-service connected disability who is unable to defray the expenses of necessary hospital care (emphasis supplied).

Thus, under appellee's construction of the False Claims

Act, a pre-1958 application for V.A. hospital care would be a

"claim" but a post-1958 application would not.

We can conceive of no better reason for rejecting that construction. Whether filed before or after 1958, the veteran's application has a single objective -- admission to a V.A. facility for free medical care. Likewise, irrespective of when filed, the application (if false) has the same effect -- the

veteran obtains, at federal expense, valuable services to which he is not entitled. In these circumstances, how can there be the adoption of any reading of the Act which puts some of these applications within the statutory coverage and leaves others free of any sanction against falsity. Stated otherwise, if Alperstein does nothing else, it demonstrates that the term "claim" cannot be given appellee's suggested meaning without rendering the False Claims Act not merely ineffective but, as well, capricious in its application.

4. Finally, little response is required to appellee's insistence (Br. pp. 26-30) that the government suffers no immediate financial detriment in connection with the making of farm storage facility loans. Indeed, we think it sufficient simply to note appellee's specific concession (Br. p. 30) that the rate of interest charged by the Government on these loans is "somewhat less than the commercial rates." Whether or not it is engaged in competition with commercial lending instituting the fact remains that the United States -- under express legislative authorization -- here lent its money for less than that money was worth. We respectfully submit that it is idle

While mot of critical importance, we note in passing that appellee is entirely unjustified in criticizing (Br. p. 42) th court's reliance in <u>United States</u> v. Cherokee Implement Co., 216 F. Supp. 374 (N.D. Iowa) upon <u>United States</u> v. <u>Brown</u>, 274 F. 2d 107 (C.A. 4). As is made clear by the discussion in <u>Broof</u> the mechanics of the Commodity Credit Corporation's Tobacco Price Support Program, loans made by C.C.C. are an integral part of that program.

to contend, as does appellee, that the recipients of these loans do not receive a direct financial benefit, or that the United States is not financially disadvantaged, to the extent of the interest rate differential.

In sum, far from warranting appellee's characterization of it as "reckless" (Br. p. 44), the government's position in this Court -- that the False Claims Act applies to all fraudulent endeavors to obtain the disbursement of government funds -- is amply supported by reason and precedent. The underlying purpose of the statute, and the manner in which it has been consistently applied, plainly preclude attempts to make the Act's coverage turn upon such niceties as whether, in connection with the false representations, the claimant asserted a legally enforceable right to the funds. Nothing, we submit, could be more irrelevant.

CONCLUSION

For the reasons stated in this brief and our main brief, the judgment of the district court should be reversed and the cause remanded for trial.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United State Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

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In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

TRANSMARINE NAVIGATION CORPORATION AND ITS SUBSIDIARY, INTERNATIONAL TERMINALS, INC., RESPONDENT

On Petition for Enforcement of an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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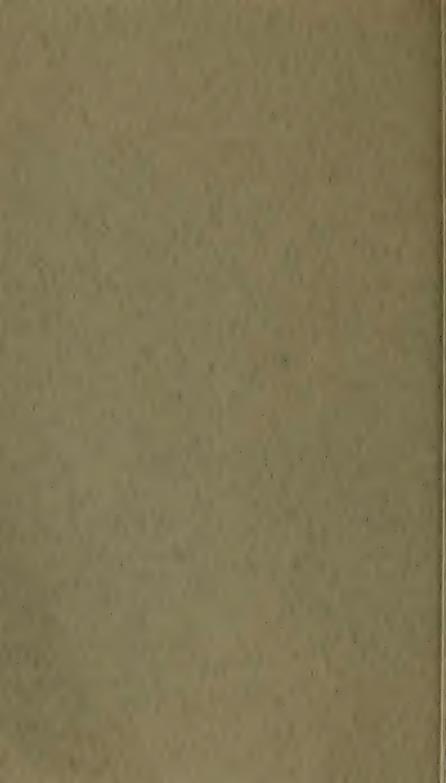
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In the United States Court of Appeals for the Ninth Circuit

No. 20964

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

TRANSMARINE NAVIGATION CORPORATION AND ITS SUBSIDIARY, INTERNATIONAL TERMINALS, INC., RESPONDENT

On Petition for Enforcement of an Order of the National Labor Relations Board

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon petition of the National Labor Relations Board to enforce its order issued against respondent (hereafter the "Company") on May 28, 1965, following proceedings under Section 10(c) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, et seq.). The Board's decision and

¹ Pertinent provisions of the Act are set forth *infra* pp. 21-23.

order (R. 20-32, 35-37)² are reported at 152 NLRB 998. This Court has jurisdiction over the proceedings under Section 10(e) of the Act, since the unfair labor practices occurred at Los Angeles, California, within this judicial circuit.

STATEMENT OF THE CASE

I. The Board's Findings of Fact

The Board found that the Company breached its bargaining obligation, in violation of Section 8(a)(5) and (1) of the Act, by entering into a joint venture agreement which involved moving its operations, agreeing to contract out necessary guard service, and therefore discharging its unit of guards, all without prior notice or discussion with the union representing the guards. The evidence upon which the Board based its finding is summarized below.

The Company (Transmarine Navigation Corporation and its wholly owned subsidiary, International Terminals, Inc., concededly a single employer under the Act) was a freight agent, ship broker, steamship agent, and terminal operator at the Los Angeles harbor (R. 20; Tr. 28-29). The Company hired employ-

² References to the pleadings and decision and order of the Board, the Trial Examiner's recommended decision and order and other papers reproduced as Volume 1, pleadings, are designated "R." References to portions of the stenographic transcript reproduced pursuant to the Rules of this Court are designated "Tr." "G.C. Ex." refers to the General Counsel's exhibits. References preceding a semicolon are to the Board's findings; those following are to the supporting evidence.

ees as guards to protect cargo on the ships and in the warehouses on the dock (R. 21; Tr. 23-30). In 1960, the American Federation of Guards, Local #1 (hereafter the "Union") was elected and certified by the Board as the collective bargaining representative of the guard unit. (R. 21; G.C. Ex. 6 (d)). Since that time a collective bargaining agreement has governed relations between the Company and the Union. The most recent agreement was concluded in 1962 and, with a termination date of June 30, 1965, was still in effect at the time of the events herein described (R. 22; Tr. 18).

In the summer of 1963,³ owing to the possible loss of its main customer, a Japanese shipowner, the Company began making plans to modify its Los Angeles operations.⁴ In August the Company began discussions with two other terminal operators about forming a joint venture to provide at the Long Beach harbor essentially the same services the Company was providing at Los Angeles. On September 5, the Company decided to close its Los Angeles operation and transfer to Long Beach, and on that date the Company consummated an agreement with the two other terminal operators. The companies entered the joint venture, known as "Sierra Terminals," with 40-40-20 percent interests, of which the Company's interest was 40 percent (R. 22; Tr. 31, 35).

³ Unless otherwise indicated, the dates hereafter refer to 1963.

⁴ The Japanese government had ordered a consolidation of Japanese shipping companies, which would require facilities larger than the Company's. (Tr. 193-194)

By September 5, the date the joint venture agreement was executed, the Company had determined that it would discharge its guards on October 31, since the joint venture had determined to contract for the use of guards employed by Newton Security Patrol, a company which had provided guards for the Long Beach terminal operator which the joint venture was replacing. Newton's guards were represented by another union, and their wage scale was almost a dollar an hour less than that received by the guards represented by the Union. The Company, however, had not revealed the joint venture agreement to the Union, and it did not notify the Union of its plan to discharge the guards (R. 21, 24-25; Tr. 38-39, 164-171, 214).

On September 15, the Company's vice-president, Lloyd Linn, told one of the guards, Ernest McClintock, that the Company was thinking of closing its Los Angeles terminal in order to join with two other companies. Linn requested that McClintock keep this information confidential. However, shortly thereafter McClintock told the Union's secretary-treasurer and business agent, Curtis Walker, that there were "rumors" that the terminal might close (R. 24; Tr. 135). About a week later, Vice-president Linn told McClintock, who held no official position in the Union, to advise the guards that they would be terminated about November 1, as the joint venture planned to use Newton Security Patrol for guard service at Long Beach (R. 24; Tr. 132, 136). Linn suggested that the guards talk to Newton about employment at Long Beach. McClintock did so, and Newton offered to

employ McClintock regularly and put the other Company guards on a stand-by basis, to work when needed. Since Newton's hourly wage scale was almost a dollar less than the Company's, the guards rejected Newton's offer (R. 24; Tr. 145).

On October 24, in a Company bulletin distributed to other employees but not to the guards, the Company president, Max J. Linder, advised the employees that they would be terminated as employees of the Company and reemployed by the joint venture at Long Beach on November 1 (R. 22; Tr. 19, G.C. Ex. 4.)

During the last week in October, McClintock had occasion to speak with Union Representative Walker. McClintock told him that what had once been rumor was now an accomplished fact; the Company had determined to end its Los Angeles operations (R. 24; Tr. 148-149). Shortly thereafter Walker received a letter from Vice-President Linn, dated October 28. The letter arrived only 2 days before all Los Angeles operations ceased, and stated as follows (R. 22; Tr. 39, 41, G.C. Ex. 5):

We regret to inform you that on October 31, 1963, International Terminals, Inc., will cease business. Accordingly, on that date our agreement of June 30, 1962 will no longer be operative.

We are sorry that this event will terminate the employment of the guards who are members of your organization. We are doing all possible to secure other employment for them. We take this opportunity to express our appreciation to you

for your consideration and cooperation in this matter.

Walker tried to reach Linn by phone as soon as he had received the letter. (Tr. 42). He was not able to reach Linn, however, until October 30, 1963 (Tr. 42). Walker asked Linn why the Company was terminating the guards. Linn said the Company was "going out of business" and "moving to Long Beach." When Walker asked Linn whether he would rehire the guards at Long Beach, Linn replied only that "he had made arrangements to hire another guard service" (Tr. 39-42). On November 1 the Company discontinued its Los Angeles harbor operations and terminated the guards (R. 24; Tr. 214).

In late November Walker telephoned Linn and asked that the Company continue to honor the unexpired contract. Linn said he would ask his attorney to confer with the Union's attorney. However, no such discussion took place between the parties (R. 36 n. 1; Tr. 42-43).

The Union filed unfair labor practice charges alleging, inter alia, that the Company had violated its bargaining obligation and on June 12, 1964, the Board issued a complaint on that ground (R. 6-12). On June 24, 1964, the Union's attorney wrote the Company suggesting a settlement. The Company, on June 25, replied that it was willing to bargain about "any matters in dispute" (R. 29; Tr. 107-108).

II. The Board's Conclusions and Order

The Board found that the Company violated Section 8(a)(5) and (1) of the Act by failing to notify

the Union before agreeing to close down its Los Angeles facility and to participate in a joint venture at Long Beach using contract guard service, and by thereafter discharging the guards before giving the Union an opportunity to negotiate concerning the effect of the joint venture agreement on the guards' employment (R. 26, 35).

The Board's order requires the Company, in addition to posting the usual notice, to make the guards whole for any loss of earnings which they suffered from the time of their discharges to the Company's acceptance on June 25, 1964, of the Union's request to bargain about the guards' employment. The Board concluded that, although a bargaining violation had been committed, in the circumstances it would not be appropriate to issue an order requiring the Company to bargain with the Union (R. 28-32, 36-37).

ARGUMENT

I. Substantial Evidence on the Whole Record Supports the Board's Finding That the Company Failed to Notify and to Confer With the Union Before Entering Into a Joint Venture to Relocate Its Operations and to Displace Its Unit of Guards With Contract Guard Service, in Violation of Section 8(a)(5) and (1) of the Act

As shown in the Statement, the Union was elected and certified as the representative of a unit of guards employed directly by the Company at its Los Angeles harbor terminal. In the summer of 1963, when the parties' current contract still had 2 years to run, the inadequacy of current facilities threatened the loss of the Company's main customer. The Company decided

to move from Los Angeles and, without notifying the Union, entered into a joint venture agreement with two other companies in order to provide a larger terminal for its customers at Long Beach harbor. Then, although transferring its other employees, the Company discharged its guards since the joint venture had obtained contract guard service, at a much lower wage rate, for the Long Beach facility. The Company notified the Union of these actions 1 or 2 days before the closedown of its Los Angeles operation. Thus, the exclusive representative chosen by the guards to represent them was notified only after the abolition of their jobs through use of a contract guard company had become a fait accompli.

The statute guarantees the employees' spokesman an opportunity to explore alternatives to a managerial decision to modify or to curtail operations when the decision would substantially affect unit work. Given the inevitability of the decision, the bargaining representative is entitled to negotiate concerning the effects thereof, e.g., whether or under what conditions the employees' jobs will be preserved and, if not, the extent of such termination rights as pensions and severance pay. N.L.R.B. v. Brown-Dunkin Co., 287 F. 2d 17, 20 (C.A. 10); Town & Country Mfg. Co. Inc. v. N.L.R.B., 316 F. 2d 846 (C.A. 5). Accord: N.L.R.B. v. Lewis, 246 F. 2d 886, 888-889 (C.A. 9); N.L.R.B. v. Mackneish, 272 F. 2d 184 (C.A. 6), enforcing 119 NLRB 162, 168, 189-190; N.L.R.B. v. Intracoastal Terminal, Inc., 286 F. 2d 954 (C.A. 5). Accordingly, the Trial Examiner correctly found that the Company had a statutory obli-

gation to confer with the Union before entering into a contractual commitment to move its Los Angeles operations and to abolish all guard employment, and to conduct its operations at Long Beach as part of a joint venture which would contract out the necessary guard service. The Company did not challenge this finding (R. 33-34), and it was properly affirmed by the Board. Moreover, that the proposed modification in operations and contracting out of unit jobs were a mandatory subject of bargaining is illustrated by the decision in Fibreboard Paper Products Corp. v. N.L.R.B., 379 U.S. 203, 204-215, which was decided shortly after the Trial Examiner issued his decision. In Fibreboard, the Supreme Court held that an employer which operated a manufacturing plant was under a duty to bargain with the statutory representative of its maintenance employees about its decision, based on lawful economic considerations, to discharge such employees and to engage an independent contractor to perform the plant maintenance work. Under the principles settled by Fibreboard an employer has, for example, the dual obligation to discuss a proposed decision to discontinue the cheese cutting and prepacking phase of his operations and to give the union reasonable notice and opportunity to negotiate concerning the effects on unit employment of such a decision. N.L.R.B. v. Winn-Dixie Stores, Inc., 361 F. 2d 512, 516-517 (C.A. 5). enforcing 147 NLRB 788. See also, N.L.R.B. v. American Manufacturing Company of Texas, 351 F. 2d 74, 80 (C.A. 5); N.L.R.B. v. Northwestern Publishing Company, 343 F. 2d 521, 526 (C.A. 7). No meaningful

distinction can be drawn between *Fibreboard* and the cited cases and a case, like the instant one, where the employer unilaterally decides to modify his operations by participating in a joint venture at a different location in the same area, with the same customers and work force except for one department of employees which he unilaterally arranges to displace with the services of an independent contractor. Cf. N.L.R.B. v. Royal Oak Tool & Machine Company, et al., 320 F. 2d 77, 82-83 (C.A. 6).

Before the Board the Company (R. 33) defended its actions solely on the ground that it had conferred in good faith with the Union in conformity with the bargaining obligation described above. The record

⁵ In clear contrast, for example, are managerial decisions which involve abandonment of an uneconomical operation in a particular market, or a major and basic redirection of an operation through reinvestment or withdrawal of capital, and which, in the view of the Third and Eighth Circuits, raise, under Fibreboard, only an obligation to bargain concerning the effects of the decision. See, N.L.R.B. v. The William J. Burns, International Detective Agency, 346 F. 2d 897, 902 n, 2 (C.A. 8) (decision to cease totally operations within the state); N.L.R.B. v. Royal Plating and Polishing Co., 350 F. 2d 191, 196 (C.A. 3) (decision, when land is to be taken by public authority, to abandon plant and not resume operation elsewhere). And see, the Board's decision on remand from the Third Circuit, 160 NLRB No. 72, decided September 8, 1966 (63 LRRM 1045). See also, N.L.R.B. v. Adams Dairy, Inc., 350 F. 2d 108, 109 (C.A. 8), cert. denied, 382 U.S. 1011.

⁶ However, after entry of the Board's decision the Company filed a motion for reconsideration, stating that since it "went out of business at the time [the] guards were discharged" (R. 38), an unfair labor practice finding and remedial order were barred under the holding in N.L.R.B. v. Darlington Mfg. Co., 380 U.S. 263. Darlington issued 2 months before the Board's

wholly refutes this assertion. Vice-President Linn commonly dealt with Union Representative Walker, but in several meetings during August 1963 Linn did not disclose that the Company was then considering moving its operations to the joint venture (Tr. 38, 215-216), and was considering whether to retain the guards with other employees or to utilize the guards then being provided at Long Beach by Newton Security Patrol (Tr. 33, 66, 76). Nor was the Union sufficiently notified or granted an opportunity for

decision and the Board, noting that the Company raised matters previously considered, denied the motion (R. 41). We submit this ruling was correct. Darlington involved Section 8 (a) (3) of the Act, which bans discrimination to discourage union membership. The decision holds that an employer is not subject to this statutory proscription when-wholly unlike the action taken by the Company—he goes completely and permanently out of business and ceases to be an employer subject to the Act's regulation. Darlington reaffirms settled doctrine that a managerial decision affecting terms and conditions of employment which is less than a total withdrawal from the entire marketplace, and which is motivated by antiunion considerations, is condemned by Section 8(a)(3) (380 U.S. at 271-274). It may scarcely be contended that these holdings were intended, contrary to the bargaining obligation earlier imposed by the Supreme Court in Fibreboard, to permit an employer to make the lesser management decisions without meeting Section 8(a)(5) requirements to confer with the employees' representative. See, N.L.R.B. v. American Manufacturing Company of Texas, supra, 351 F. 2d at 79 n. 10, 80.

Darlington leaves open the issue of whether a complete going out of business not only may absolve an employer of liability for antiunion discrimination, but also may absolve him of statutory bargaining duties. The Supreme Court noted that it had no occasion to pass on this issue. (380 U.S. at 267 n. 5, 272 n. 14). Obviously the issue is not presented here. Darlington has no relevance to this case.

discussion by virtue of Linn's statements to one of the guards (McClintock) in mid-September, as the Company asserted before the Board. McClintock was not authorized to speak for the Union. Furthermore, Linn's discussions with McClintock all took place after the September 5 joint venture agreement and the decision to displace the guards had already taken place. McClintock was only told initially, and somewhat inaccurately, that the Company was "thinking" about the move. Moreover, he was asked to keep the information confidential, and, in a subsequent discussion with Union Representative Walker, McClintock spoke only of a "rumor" that the Los Angeles terminal was to be closed.

In late September Linn told McClintock of the impending move and that the guards would be discharged on November 1, when the Company would discontinue the terminal. Linn, however, still ignored the Company's obligation to treat with the employees' representative. Thus Linn himself arranged the unfruitful discussions, between McClintock and Newton, concerning the guards' possible employment by Newton after November 1. Any notion that the Company intended Union participation in such discussions, through full disclosure to the guards them-

⁷ During the hearing, the Company asserted that McClintock was a Company supervisor; however, the Trial Examiner concluded he was a rank-and-file employee. As the Examiner noted, the Company apparently abandoned the supervisory contention in recognition that it was inconsistent with the claim that discussions with McClintock satisfied the obligation to confer with the Union (R. 23 n. 3). The Company does not contest the Trial Examiner's employee finding (R. 33-34).

selves, is also negated by the exclusion of the guards from distribution of the Company bulletin of October 24, which explained the relocation: the guards normally received such bulletins (Tr. 69-71). The Company's conduct, in short, gives no support for a conclusion that by discussions with the unit employees the Company fulfilled the affirmative duty to take no such action affecting employment without prior consultation with the employees' representative, N.L.R.B. v. Tom Joyce Floors, Inc., 353 F. 2d 768, 772 (C.A. 9). As stated by the Tenth Circuit in similar circumstances (N.L.R.B. v. Brown-Dunkin Co., supra, 287 F. 2d at 20):

While the Union appears to have had some intimation of the impending [contract to subcontract maintenance work], it was not until the morning of the effective date of the contract that the Union learned it had been consummated and this information was obtained through the employees, not the employer. Under no stretch of the imagination can it be said that these circumstances gave the Union a fair opportunity to bargain with [the Company] about not subcontracting the work, or . . . the conditions of new employment.

Accord: Industrial Union of Marine and Shipbuilding Workers of America, AFL-CIO v. N.L.R.B. (Bethlehem Steel Co.), 320 F.2d 615, 620 (C.A. 3), cert. denied, 375. U.S. 984.

The above principles equally dispose of the Company's contention that notification to the Union 2 days before closing of the Los Angeles terminal pre-

sented the Union with the opportunity to request negotiations. The Company's letter was one of farewell, not of invitation. Little was left to negotiate. (see. supra pp. 5-6). This is demonstrated by Linn's response to the Union's immediate inquiry and attempt to salvage at least some employment with the Company at Long Beach. Asked to consider using the guards there, Linn stated that he had made "other arrangements." The Company's assertion that a bargaining opportunity arose in late November has even less foundation. Apart from the impossibility of meaningful discussions at that juncture, the Company still gave no indication that it would meet with the Union and explore the guards' employment. Thus, the Company having stated in its letter that the parties' unexpired contract was "no longer . . . operative." the Union telephoned to request that the agreement be honored. Linn said he would confer with the Union's attorney, but he apparently did not do so. An unfilled commitment to the employees' representative is not collective bargaining.8

Finally, the Company's unilateral actions may not be defended on the ground that the decision to enter

⁸ The Company, moreover, put misplaced reliance on an alleged lack of solicitude by the Union once it heard rumors of the impending move to Long Beach. As the Sixth Circuit held of a similar contention, "Although the union's conduct in neglecting to negotiate during an eight month period, was certainly not exemplary, it seems to us that it constituted more of a violation of a duty owing to its members than to [the employer]." McLean v. N.L.R.B., 333 F. 2d 84, 888 (C.A. 6). Cf. N.L.R.B. v. The Item Co. 220 F. 2d 956, 958-959 (C.A. 5).

the joint venture at Long Beach was required in order that the Company might remain in business, and that the decision had to be made quickly and kept confidential. The Act sometimes contemplates less than "full-scale collective bargaining" on a mandatory subject, and "statutory bargaining requirements should be flexibly administered to meet the needs of the particular case." District 50, UMW v. N.L.R.B., 358 F. 2d 234, 238 (C.A. 4) (affirming Board's view that the need for prior notice and the adequacy of the discussion regarding a decision to subcontract are dependent, inter alia, upon the impact on the employees). The Company was only required to make a reasonable accomodation of the alleged business necessities with the duty to give the Union notice and opportunity for discussion. The Company, however, was not authorized to bypass the Union entirely. Furthermore, none of the alleged factors explain the Company's failure to confer with the Union before arranging for displacement of the guards and actually discharging them, and thereby depriving the Union of any negotiations concerning the effects of the joint venture on the guards' employment. Though a minority member of the joint venture, the Company was surely situated to urge any Union suggestion; it was able to retain its remaining work force. Indeed, before the Board the Company stressed its right to withdraw from the consummated joint venture agreement if a more advantageous alternative became feasible. possibility thus existed that the guards' employment opportunities could have been wholly or partially preserved. Plainly, the "chances [were] good enough to

warrant subjecting [this issue] to the process of collective negotiations." Fibreboard Paper Products Corp. v. N.L.R.B., supra, 379 U.S. at 214.

The Board properly rejected the Company's attack on the Trial Examiner's recommended backpay order (R. 35-36). It is now settled that an economic decision taken unilaterally in violation of the bargaining requirements of Section 8(a)(5) and (1) of the Act may be remedied by an order restoring the status quo ante. For example, a unilateral decision to modify operations which abolishes unit jobs may appropriatetly be remedied by requiring the employer to resume the operation with his own employees; to reimburse them for any lost earnings from the date of job deprivation to their reinstatement; and to bargain about the decision. Fibreboard Paper Products Corp. v. N.L.R.B., supra, 379 U.S. at 215-217. Town & Country Mfg. Co. v. N.L.R.B., 316 F. 2d 846 (C.A. 5) In the instant case (see supra pp. 6-7), the substantive portions of the Board's order are much narrower. In all the circumstances the Board determined that restoration, reinstatement, and bargaining were not appropriate. The Board, however, directed the Company to make its guards whole for any loss of earnings they incurred from the time of their discharges (November 1, 1963) until the Company agreed to bargain with the Union concerning the guards' employment (June 25, 1964). This limited relief is well within the Board's broad authority to frame appropriate remedial orders. Fibreboard Paper Products Corp. v. N.L.R.B., supra 379 U.S. at 215-216.

The Company asserted that no backpay was warranted in view of its notification letter to the Union on October 28, Vice-president Linn's discussion with Union Representative Walker on October 30, and the telephone conversation between Linn and Walker in late November. These Company actions assertedly satisfied the obligation to bargain prior to the guards' discharges. However, as shown supra, pp. 10-15, the Company did not negotiate. The Company handed the Union a fait accompli and declared that the parties' contract and bargaining relationship were terminated. As the Board noted, this is not "collective bargaining within the Act's meaning" (R. 36). Imposing liability for possible loss of earnings up to the date the Company agreed to perform that statutory duty, is a rational requirement, N.L.R.B. v. Winn Dixie Stores, supra, 361 F. 2d at 515 n. 6; N.L.R.B. v. American Mfg. Co. of Texas, supra, 351 F. at 80-81. Cf. N.L.R.B. v. Exchange Parts, 339 F. 2d 829, 831-832 (C.A. 5). The Company chose to transgress employee rights, and is ill situated to insist on virtually total exculpation. The redress ordered is appropriate; it achieves "a balanced and economically feasible accomodation between the interests of the parties." District 50, UMW v. N.L.R.B., supra, 358 F. at 238.

CONCLUSION

For the foregoing reasons, we respectfully request that the Board's order be enforced in full.

⁹ Additional contentions, though not raised in the Company's brief to the Board, were contained in the Company's exceptions to the Trial Examiner's decision (R. 34). They have no merit. (1) The alleged contract right of the Union to invoke the grievance procedure in the parties' agreement (see R. 26-27) does not prevent the Board from remedying the Company's unfair labor practices which infringed on statutory rights. N.L.R.B. v. Walt Disney Productions, 146 F. 2d 44, 47-49 (C.A. 9), cert. denied, 324 U.S. 877; N.L.R.B. v. Thor Power Tool Co., 351 F. 2d 584, 587 (C.A. 7). (2) The Board's Rules requiring the General Counsel to produce for cross examination the investigatory pre-hearing statements taken from his witnesses, clearly did not require the General Counsel to produce a prehearing statement of the Company's own witness (McClintock). See, N.L.R.B. v. Vapor Blast Mfg. Co., 287 F. 2d 402, 407 (C.A. 7), cert. denied, 368 U.S. 823. Moreover, the Company did not, and could not, show prejudice. Thus, the Company apparently sought to show that McClintock's statement indicated his supervisory authority As shown supra p. 12 n. 7, the (Tr. 109, 156-163). Company filed no exceptions to the Examiner's nonsupervisory finding, and is barred from further raising it. N.L.R.B. v. International Union of Operating Engineers, Local 66, etc., 357 F. 2d 841, 846 n. 10 (C.A. 3). (3) The Board properly included guards Campbell and Gill in the backpay order. As the Board noted (R. 24, 28-29) the record did not reveal whether the two men were regularly employed, or employed at all, at the time of the Company's unlawful unilateral action. Accordingly, as usual in such circumstances, this issue and the amount of lost earnings, if any, will be determined at the compliance stage of the proceedings, after entry of the Court's decree. If not amicably resolved, the issue will go to supplemental Board proceedings. N.L.R.B. v. Local 776, IATSE (Film Editors), 303 F. 2d 513, 521 (C.A. 9), cert. denied, 371 U.S. 826; N.L.R.B. v. J.H. Rutter-Rex Mfg., Inc., 245

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CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and in his opinion the tendered brief conforms to all requirements.

Marcel Mallet-Prevost, Assistant General Counsel, National Labor Relations Board.

F. 2d 594, 597-598 (C.A. 5). See, *NL.R.B* v. *Deena Artware*, *Inc.*, 361 U.S. 398, 411; *N.L.R.B*. v. *Ellis & Watts*, 344 F. 2d 67 (C.A. 6).

APPENDIX A

Pursuant to Rule 18.2(f) of the Rules of the Court

GENERAL COUNSEL'S EXHIBITS

No.	Identified	Received in Evidence
1(a) through 1(n)	5	5
2	17	18
3	18	18
4	18	19
5	19	20
6(a) through 6(d)	21	22
7	39	41

APPENDIX B

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, et seq.) are as follows:

RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective baraining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8 (a) (3).

UNFAIR LABOR PRACTICES

- Sec. 8 (a) It shall be an unfair labor practice for an employer—
 - (1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;
 - (5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9 (a).

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the em-

ployees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: * *

PREVENTION OF UNFAIR LABOR PRACTICES

Sec. 10 (a) The Board is empowered, as hereinafter provided, to prevent any person from engaging in any unfair labor practice (listed in section 8) affecting comerce. This power shall not be affected by any other means of adjustment or prevention that has been or may be established by agreement, law, or otherwise: * * *

* * * *

(e) The Board shall have power to petition any court of appeals of the United States, . . . within any circuit . . . wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole

or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the hearing before the Board, its member, agent, or agency, the court may order such additional evidence to be taken before the Board, its member, agent, or agency, and to be made a part of the record Upon the filing of the record with it, the jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the . . . Supreme Court of the United States upon writ of certiorari or certification as provided in section 1254 of title 28.



No. 20964

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

VS.

TRANSMARINE NAVIGATION CORPORATION and Its Subsidiary, International Terminals, Inc.,

Respondent.

On Petition for Enforcement of an Order of the National Labor Relations Board

RESPONDENT'S BRIEF

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VS.

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Respondent.

On Petition for Enforcement of an Order of the National Labor Relations Board

RESPONDENT'S BRIEF

STATEMENT OF THE CASE

The facts must be set straight.

The Company operated a terminal in Wilmington, California, at Los Angeles Harbor, and had one Japanese ship line as its principal customer. During the summer of 1963, the Japanese Government ordered 60 Japanese ship lines, including the Company's customer, to merge into six great shipping companies. The Company's facilities, personnel and capital were totally inadequate and incapable of attracting or servicing any of the newlymerged large lines [TR pp. 192-194].

By August 1963, it was known the new lines were about to sign contracts with large West Coast marine operators. The Company faced financial ruin as it was to lose its principal customer which had been merged into a new line. Two other small companies, California Maritime Services and Jones Stevedoring Company, faced a similar crisis. These companies agreed with haste to liquidate their respective businesses and to reinvest their capital in a new enterprise to be called Sierra Harbor Terminals, which would operate a greatly expanded and diversified maritime business at modernized facilities in Long Beach and which, hopefully, would attract one of the new merged lines. Any delay in forming Sierra would have meant financial disaster [TR p. 194 lines 1-4]. A joint venture agreement was executed on September 5, 1963.

On November 1, 1963, when Sierra opened in Long Beach Harbor, the Company liquidated all its physical assets, terminated all its employees and reinvested its capital in the new enterprise. The Company, since then, has had no business, employees, property, or assets except for its minority interest in Sierra Harbor Terminals [TR 187 lines 13-25].

It is undisputed the Company took these steps as a result of dire and compelling economic necessity. There was no anti-union animus whatsoever. No one contends that there was any feasible alternative. The Company's decision was dictated solely by the Japanese and was completely beyond the control of the Company. The Company's decision was greeted with approval by most of its workers, many of whom were given employment by Sierra.

This litigation is concerned with approximately six security guards who formerly worked for the Company. They represented about one-tenth of the Company's work force and had their own union. They performed watchman duties at the Wilmington Terminal. The Company concedes that at no time before it signed the September 5, 1963 Agreement did it (the Company) bargain with the guard union concerning the wisdom of joining Sierra. The principal legal issue, as discussed later, is whether it was obligated to do so.

In order that the legal issue be placed in its proper context, it is necessary to correct certain serious errors of omission or commission in the Board's brief.

First, the Board states the Company refused to bargain about its decision to join Sierra. In fact, there is no evidence the Company ever refused to bargain or ever received an invitation to do so.* The evidence showed only that the Company did not seek out this union that represented one-tenth of its employees prior to signing the joint venture agreement and invite it to bargain about the wisdom or necessity of joining Sierra. On this basis the Board has found a "refusal" to bargain.

Second, the Board suggests the Union desired to bargain. The fact is, however, that the Union has never to this date asked to bargain about the decision to close the terminal or the effect thereof on the guards. Indeed, the Union has never replied to the Company's specific expressions of willingness to bargain. This is not a case where

^{*} The union business agent admitted no bargaining request was ever made (TR p. 55 lines 8-19).

the Company refused to bargain, but rather a case where the Union did not have any desire to bargain.

Third, the Board stated that the Union received only three days' advance notice of the Company's closing. The facts are, however, that the Company's closing was publicly announced on September 15 and the news was carried in all local newspapers and trade journals [TR p. 205 line 18, p. 706 line 15]. At about the same time, or shortly after, each of the guards was personally advised of the prospective closing [TR p. 137 lines 1-14]. The Board cannot pretend the Union was ignorant of a matter which was public knowledge and known personally to each of its members.

Fourth, the Board erroneously stated the Company decided that the security guard work at Sierra would be subcontracted. In fact, however, that decision was made by Sierra and not by the Company [TR p. 176 lines 9-23] and this decision was not incorporated in the joint venture agreement. It was made by Sierra some time after the agreement had been signed [Trial Examiner's Decis. p. 8 lines 35-8]. There is no evidence whether the Company agreed with or even participated in Sierra's decision.

Fifth, the Board urges it was possible the Company could have made arrangements for Sierra to hire the Company's guards. The fact is, however, that Sierra's facilities needed two guards at most and at times less than two. This is because Sierra's modern facilities in Long Beach were entirely enclosed as distinguished from the Company's former facilities at Wilmington, California [TR p. 225 lines 13-25]. In short, most of the Company's guards were not needed by Sierra and it does not stand to reason

the Company could have convinced Sierra to hire persons it did not need.

Sixth, the Board seeks to draw some sinister meaning from the fact that a Company memorandum of October 24 was distributed to most of the Company's employees but not to the guards or marine clerks [Exhibit 4]. The reason is that the memorandum contained the advice that Sierra would offer employment to certain of the employees who desired to work for Sierra. Since Sierra had not offered employment to the guards or marine clerks, there was no reason for the Company to distribute the memorandum to them as it did not concern them.

Seventh, the Board's brief ignores the evidence reflecting the Company's sympathetic attitude toward the guards. The Company gave each guard 4-6 weeks notice of his prospective termination so they could obtain other jobs [TR p. 137 lines 1-14]. The Company frequently inquired of the guards as to their success in lining up other employment and volunteered to assist them in any possible way. The Company offered to contact other guard employers and, on its own initiative, obtained job offers for all the displaced guards with the contractor who was to furnish guard services to Sierra [TR p. 173 lines 14-17]. Moreover, the Company wrote letters of recommendation for the individual guards to other prospective employers [TR p. 209 lines 3-8].

There is one final point in the Board's brief demanding correction and that deals with the Board's ruling. The Board held, in adopting the trial examiner's conclusion, that the Company "by entering into the agreement" with Jones Stevedoring Company and California Maritime committed an unfair labor practice, i.e., refusal to bargain [Trial Examiner's Decis. p. 8 lines 42-6]. The Board did not hold, as its opening brief claims, that the Company, after making the decision, refused to bargain about the effect of that decision upon the guards.*

ARGUMENT OF THE CASE

I

THE BOARD ERRONEOUSLY CONCLUDED AS A MATTER OF LAW THE COMPANY WAS OBLIGATED TO BARGAIN WITH THE GUARD UNION BEFORE DECIDING TO TERMINATE ITS BUSINESS AND REINVEST ITS CAPITAL IN A NEW JOINT VENTURE.

The principal issue is clear: whether a company's decision, based solely upon greatly changed economic conditions, to terminate its business and reinvest its venture capital in a different enterprise is subject to mandatory bargaining. The Board asserts it is, and the Company urges it is not.

^{*} The Company wishes to make clear that it does not and never has denied the union's right to bargain about the effect of this decision, as contrasted to the decision, upon the guards. Indeed, the Company during these proceedings has repeatedly expressed its willingness to bargain on the effect and there is no reason why bargaining on this point cannot be as effective now as at any time in the past. In such proceedings the parties bargain about the effect of the decision on the displaced employees. Rights to termination pay, vacation pay, pension pay, are frequent subjects in such bargaining.

One must remember that the Company, in deciding to join Sierra, made very fundamental changes in the direction and operation of the Company and its capital, assets and personnel. These basic changes were made in the Company: (1) Ownership — the Wilmington operation was solely owned by the Company whereas ownership of Sierra's Long Beach operation is shared with two additional companies; (2) Control — The Wilmington operation was solely controlled by the Company, whereas Sierra's control is shared by three parties and the Company has only a minority voice; (3) Capital Structure - the Company in Wilmington had working capital of only \$40,000, whereas Sierra has two and a half times that amount; (4) Employees — Sierra has three times the former employees of the Company and they work in many fields which did not exist in the Company, including longshoring, whereas the Company now has no employees of any description; (5) Nature of the Business — Sierra offers large terminal services, expert stevedoring and longshoring, whereas the Company offered a small terminal service; (6) Facilities — Sierra's are far larger, more modern and located at Long Beach Harbor, whereas the Company operated a small, outdated terminal in Wilmington at Los Angeles Harbor; (7) Customers — Sierra has a larger merged line which includes approximately ten times the size of the Company's former customers; and (8) Need for Guard Services - Sierra needs only two, whereas the Company, due to its poorly designed facility, required approximately six.

The Board asserts that a Company cannot make these basic changes in its operation for demanding economic reasons without first consulting and bargaining with a Union.* The Board relies principally upon Fibreboard Paper Products Corp. v. Labor Board, 379 U.S. 203, 85 S.Ct. 398, 13 L.ed.2d 233, but a fair reading of the Court's opinion reveals that holding was limited to situations wherein an employer eliminates union members and brings in other workers employed by an independent contractor to do the same work under similar conditions of employment. The Court's opinion clearly did not hold that an employer must bargain with a Union before making fundamental changes in the Company's capital structure and entire operation. Indeed, the Court said at p. 213:

"The facts of the present case illustrate the propriety of submitting the dispute to collective bargaining. The Company's decision to contract out the maintenance work did not alter the Company's basic operation. The maintenance work still had to be performed in the plant. No capital investment was contemplated; the Company merely replaced existing employees with those of an independent contractor to do the same work under similar conditions of employment. Therefore, to require the employer to bargain about the matter would not significantly abridge his freedom to manage the business." [italics added]

At. p. 213:

"We are thus not expanding the scope of mandatory bargaining to hold, as we do now, that the type

^{*} A Union which represented less than a tenth of the Company's employees and had no control whatsoever over the economic necessity dictating such changes. The only function performed by these men was that of watchmen.

of 'contracting out' involved in this case — the replacement of employees in the existing bargaining unit with those of an independent contractor under similar conditions of employment — is a statutory subject of collective bargaining under 8(d). Our decision need not and does not encompass other forms of 'contracting out' or 'subcontracting' which arise daily in our complex economy." [italics added]

In a separate concurring opinion, joined in by Mr. Justice Douglas and Mr. Justice Harlan, Mr. Justice Stewart elaborated at Page 218:

"The Court most assuredly does not decide that every managerial decision which necessarily terminates an individual's employment is subject to the duty to bargain. Nor does the Court decide that subcontracting decisions are as a general matter subject to that duty. The Court holds no more than that this employer's decision to subcontract this work, involving 'the replacement of employees in the existing bargaining unit with those of an independent contractor to do the same work under similar conditions of employment' is subject to the duty to bargain collectively. Within the narrow limitations implicit in the specific facts of this case, I agree with the Court's decision." [italics added]

Nor is the Board's position comforted by the other cases it cites, as the facts therein are clearly distinguishable. In *NLRB v. Northwestern Publishing Co.*, 343 F.2d 521, (7th Cir. 1965), and *NLRB v. American Manufacturing Co. of Texas*, 351 F.2d 74 (5th Cir. 1965), the employer eliminated workers because of anti-

union animus. In *NLRB v. Royal Oak Tool & Machine Co.*, 320 F.2d 77, (7th Cir. 1963), the company simply spun off its grinder divison and both corporations continued under the same ownership, control, capital structure, trade name and essentially unchanged in any material respect.

The Company invites the Court's attention to the following cases, each of which is factually closer to the case at bar, and each of which repudiates the Board's contentions. In NLRB v. William J. Burns Int'l. Detective Agency, Inc., 346 F.2d 897 (8th Cir. 1965), the employer elected unilaterally for economic reasons to terminate its branch office in one city and discharged its security guards there. It continued its operations in other cities. The Eighth Circuit decision carefully reviewed Fibreboard and concluded that, unlike the Fibreboard situation, Burns was not continuing the same work at the same plant under similar conditions of employment and, accordingly, under Fibreboard, Burns had no obligation to bargain concerning the closing of its office. The Board's finding of a refusal to bargain and a back pay order were set aside.

In NLRB v. Adams Dairy, Inc., 350 F.2d 108 (8th Cir. 1965), the employer decided unilaterally for economic reasons to terminate its driver-salesmen and assign their routes to independent contractors. The Eighth Circuit held that there was more involved than just the substitution of one set of employees for another, as in Fibreboard. Here, the employer sold its trucks and divested itself of control over the routes. The Court, accordingly, rejected the Board's contention that the com-

pany decision to alter its method of operation was a subject for mandatory bargaining. Instead, the Court held this decision was a management prerogative. Again, the Court reversed the Board's finding of a refusal to bargain and set aside its back pay order. The Supreme Court recently denied certiorari, 382 U.S. 1011.

The Third Circuit decided NLRB v. Royal Plating and Polishing Co., 350 F.2d 191 (3rd Cir. 1965), wherein an employer unilaterally closed one of its two manufacturing plants for economic reasons. The Court observed that, unlike Fibreboard, this employer was making a major change in the economic direction of the company. The company had elected to withdraw its capital investment in the closed plant and recommit it elsewhere and this decision, the Court held, is clearly a management decision about which no bargaining is required. In remanding the case to the Board, the Court observed that since the Union had expressed no interest in bargaining about the effect of the closing, as distinguished from the decision to close (as in our case at bar), it was probable no remedial order was indicated.

A decision which predated Fibreboard but has been cited frequently since then and still represents good law is NLRB v. Rapid Bindery, Inc., 293 F.2d 170 (2nd Cir. 1961), wherein the employer unilaterally closed its Dunkirk, New York, printing operation and moved it a short distance to a nearby city because its principal customer insisted it do so. The Board found an 8(a)(1) and 8(a)(5) violation for refusal to bargain with the Union about the decision to close the Dunkirk facility. The Second Circuit set aside the Board's finding and back

pay order, as the decision to close the plant "was clearly within the realm of managerial discretion". [Page 176]

Some common sense proves the justice of these recent decisions. Businessmen should have the freedom to manage their own businesses and to invest or withdraw their capital as economic circumstances dictate. To hold that a businessman must first bargain with each of the Union representing any of the employees before making a decision urgently dictated by economic conditions would "significantly abridge" his freedom, the very thing the Supreme Court in *Fibreboard* declared should not be done.

In summary, the Board's decision was based upon a misinterpretation of *Fibreboard*, as is clearly shown in the recent decisions of the Second, Third and Eighth Circuits. The Board's petition for enforcement of its order should be denied and its order set aside.

П

THE BOARD'S BACK PAY ORDER IS IMPROPER

If the Court rules, as the Company urges, that an employer has no duty to bargain about a decision to make a major change in the direction of his business, the back pay order should be set aside.

If the Court rules against the Company's contention, the order should *still* be set aside. This is because the Board found only two guards would have been used at Sierra in the event the Union's bargaining had been successful. Thus, two men at most have been deprived

of work they otherwise would have had. The Board concluded, however, that since no evidence had been heard as to which of the six guards would have been employed at Sierra, that it was "appropriate" the Company pay back wages to all six [Trial Examiner's Decis., pp. 9-10]. The most equitable solution would be to hear evidence in supplementary Board proceedings as to which two men would have been assigned the work. This is easily ascertainable as assignment of the work probably would be made on the basis of seniority. Indeed, the Board itself suggests supplementary proceedings to determine which men were employees [Brief p. 18].

CONCLUSION

The Board found the Company's decision to join Sierra was motivated entirely by urgent economic problems and not in any way by a desire to avoid contractual obligations with the Union [Trial Examiner's Decision, p. 9, lines 33-36]. No party has suggested the Company had any other alternative, and all must agree the economic circumstances were far beyond the control of the Company's watchmen. It would be a futile act to require the Company to bargain with the guards about the desirability of joining Sierra, where there was no other alternative and, especially, where the watchmen had no knowledge of the economic conditions demanding the change. The law has never required the doing of a futile act and it should not impose punishment upon the Company, in these circumstances, because it did not seek out the Union and invite bargaining about the wisdom of joining Sierra.

It would be an intolerable restraint on a businessman to require him to bargain with a watchman's Union in these circumstances about the advisability of making basic changes in the business. Not only would it be an invasion of management's prerogative, but it would cause delays in making managerial decisions that could have disastrous effects. Moreover, the capital is owned by the businessmen and it is only equitable that it should have the unfettered right to invest or reinvest it as economic conditions dictate.

Finally, it should be noted that the Board seeks in this case to apply a rule of law unknown in 1963 when these events took place. The Board has dilatorily handled this case during three succeeding years and now, on the basis of recent holdings, seeks to extract penalties, with interest, in the amount of \$20,000. The probable effect of the Board's ruling would be to cause liquidation of the Company and throw Sierra's employees out of work. Clearly, the Board's order will not effectuate the purposes of the Board's Act.

Respectfully submitted,

LILLICK, GEARY, MCHOSE & ROETHKE L. ROBERT WOOD FRANCIS J. MACLAUGHLIN

Attorneys for Respondent

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

Francis J. MacLaughlin



In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER , v.

TRANSMARINE NAVIGATION CORPORATION AND ITS SUBSIDIARY, INTERNATIONAL TERMINALS, INC., RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

REPLY BRIEF AND SUPPLEMENTAL APPENDIX FOR THE NATIONAL LABOR RELATIONS BOARD

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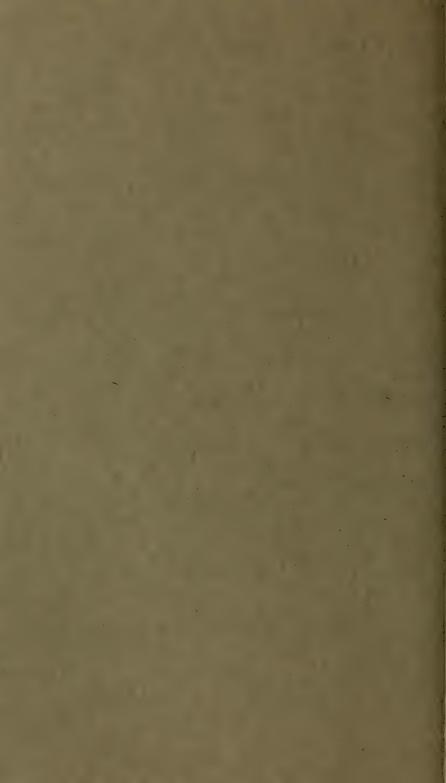
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In the United States Court of Appeals for the Ninth Circuit

No. 20964

National Labor Relations Board, petitioner v.

TRANSMARINE NAVIGATION CORPORATION AND ITS SUBSIDIARY, INTERNATIONAL TERMINALS, INC., RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

REPLY BRIEF AND SUPPLEMENTAL APPENDIX FOR THE NATIONAL LABOR RELATIONS BOARD

This reply brief is directed to arguments in the Company's brief heretofore not asserted, and therefore not wholly dealt with in the Board's opening brief.

1. The Company devotes almost its entire brief to a contention that the Act imposed no obligation to bargain with the Union concerning the decision to close the Los Angeles terminal, enter the joint venture at Long Beach and replace the unit of guards with contract guard service. However, as shown in our opening brief (pp. 9-10), the Company made no contention before the Trial Examiner and the Board that a managerial decision of this character was not a mandatory subject of bargaining. The Company's

defense was that it had fully satisfied the bargaining requirements involving both the decision and the effects thereof on the employees. (See, R. 33–34).

The Company now seeks to rely on decisions of the Third and Eighth Circuits (see Bd. Br. 10, n. 5), holding that a managerial decision may be made unilaterally when it involves a basic redirection of the enterprise through a major re-investment of capital or relocation in another market. As we show in our opening brief (p. 10, n. 5) where the decision involves such elements, in the view of those Circuits, prior consultation regarding the decision is not required

¹ As set forth in our brief (p. 10, n. 6) after the Board's decision the Company unsuccessfully moved for reconsideration on the ground that the Supreme Court's decision in N.L.R.B. v. Darlington Mfg. Co., 380 U.S. 263, barred a remedial order. As we show, this assertion rested on the inaccurate claim that the Company had totally and permanently gone out of business. In this connection, see N.L.R.B. v. Wayne Johnson (Carmichael Floor Covering Co.), No. 20,760 (C.A. 9), October 17, 1966, (63 LRRM 2331), decided after submission of the Board's brief, where this Court affirmed the Board's holding that the employer violated the bargaining requirements of the Act by unilaterally contracting out its floor covering installation work. The Court characterized Darlington, relied on by the employer, as "not in point," as "[t]hat case involved the closing of an entire plant, not the continuance of essentially the same operation by substituting independent contractors for the employer's own workers" (63 LRRM at 2332, n. 2). The Court's decision supports the Board's decision herein in other Thus, the Court found no merit in the employer's assertion (see, Comp. Br. 3-4) that the absence of a clear union request to bargain about a decision affecting unit employment was a defense when the employer makes the decision unilaterally and then confronts the union with a "fait accompli" (63 LRRM at 2332, n. 1). Further, the Court enforced inter alia a similar backpay order. (See Bd. Br. 16.)

under the Supreme Court's holding that a decision to displace unit jobs with an independent contractor is a mandatory subject of bargaining. Fibreboard Paper Products Corp. v. N.L.R.B., 379 U.S. 203. Rather, in their view the statute requires only negotiations concerning the effects of the decision. However, as shown, the Company's decision to participate in a joint venture in the same area with the same customers and work force except for one department of employees which it arranged to replace with an independent contractor, is not the equivalent of the "basic" managerial decisions involved in the Third and Eighth Circuit cases.2 Indeed, before the Board the Company indicated that the issue was whether it had met its statutory obligation to confer with the employees' representative before displacing unit jobs, and the Company defended its conduct on the ground that it was similar to employer conduct in Board cases where it was held that the representative had been given adequate opportunity to negotiate before the decision was made and implemented (R. 25-26,

² In Ozark Trailers, Incorporated, et al., 161 NLRB No. 48, October 27, 1966, (63 LRRM 1264), decided after the Board's brief and involving a unilateral decision to shut down an entire plant, the Board indicated its disagreement with the principle that where the decision involves basic changes in capital structure or relocation of an enterprise in a different market Fibreboard requires negotiations on only the effects of the decision. Although, as demonstrated, the instant case does not raise this issue, in view of the Board's thorough examination of Fibreboard the Court may desire to have before it the Board's decision in Ozark. Therefore, with the Trial Examiner's recommended decision omitted, we have for the Court's convenience included the Board's decision, as yet not reported in the bound volumes, as an appendix to this brief, infra.

- 28, 36). In sum, it is manifest, and until now the Company has not suggested otherwise, that the unilateral action the Board found unlawful here involved "the replacement of employees in the existing bargaining unit with those of an independent contractor." Fibreboard, supra, 379 U.S. at 215.
- 2. Even under the court holdings on which the Company seeks to rely, the Company failed to give the Union the required opportunity to negotiate concerning the effects of the decision to abolish unit employment. Accordingly, those holdings support enforcement of the Board's order on this adequate ground. The Company states (Br. 5, 6, footnote) that the Board held solely that the Company violated the statutory bargaining obligation by failing to bargain with the Union concerning the decision to participate in the joint venture and to displace the unit of guards with contract guard service, and that the Board did not hold that the Company failed to bargain with the Union about the effects of the decision on unit employment. This is a misstatement. Clearly at issue was performance of both the duty to discuss the proposed decision with the Union and the duty, if not persuaded to avoid or modify the decision, to discuss its effect on the employees. The Board determined that the Company not only bypassed the Union in making the decision, but also gave it no opportunity

for meaningful "bargaining with respect to the effect of the [decision] on the Union members" (R. 25-26, 35–36). Furthermore, in the circumstances presented here, the General Counsel elected not to seek the usual remedy for the unilateral decision—that is, restoration of the unit and opportunity for the bargaining representative to negotiate concerning alternatives to the unit's abolishment. Thus, the central issue presented was whether the Company, before discharging the guards, had provided the Union with opportunity to bargain concerning the effects of the decision, and should therefore not be held for the usual backpay liability. As we show in our opening brief, the Trial Examiner and the Board properly held that until the Company offered to confer with the Union on all matters in dispute on June 25, 1964—several months after the Company entered the joint venture and replaced its guards—the Company had not fulfilled its duty to engage in "collective bargaining within the Act's meaning about the status of the terminated employees" (R. 26, 36). The Company's statement that the Board did not find that the Company breached its duty to negotiate concerning the effects of the decision is, in short, squarely in conflict with the major thrust of the Board's decision. In addition, as shown by the discussion, supra, the contention is at variance with the Company's arguments in the earlier stages of this proceeding.

CONCLUSION

For the reasons stated herein and in our main brief, we respectfully submit that a decree should issue enforcing the Board's order in full.

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Attorneys, National Labor Relations Board.

NOVEMBER 1966.

CERTIFICATE

The undersigned certifies that he has examined the provisions of rules 18 and 19 of this court, and in his opinion the tendered brief conforms to all requirements.

Marcel Mallet-Prevost,
Assistant General Counsel,
National Labor Relations Board.

APPENDIX

United States of America before the National Labor Relations Board

Case No. 17-CA-2414

OZARK TRAILERS, INCORPORATED AND/OR HUTCO EQUIPMENT COMPANY AND/OR MOBILEFREEZE COMPANY, INC. AND INTERNATIONAL UNION, ALLIED INDUSTRIAL WORKERS OF AMERICA, LOCAL NO. 770, AFL-CIO

Decision and Order

On December 14, 1964, Trial Examiner Sidney S. Asher, Jr., issued his Decision in the above-entitled proceeding, finding that Respondent had engaged in certain unfair labor practices and recommending that it cease and desist therefrom and take certain affirmative action, as set forth in the Decision attached hereto. The Trial Examiner also found that Respondent had not engaged in certain other unfair labor practices and recommended that the complaint be dismissed with respect to such allegations. Thereafter, Respondent filed exceptions to the Trial Examiner's Decision, and also filed a supporting brief.

The Board has reviewed the rulings of the Trial Examiner made at the hearing and finds that no prejudicial error was committed. The rulings are hereby affirmed. The Board has considered the Trial Examiner's Decision, the exceptions and brief, and the entire record in this case, and hereby adopts the findings, conclusions, and recommendations of the Trial Examiner, with the following modifications:

1. The Trial Examiner found, and we agree, for the reasons set forth in the Trial Examiner's Decision, that Ozark Trailers, Incorporated, herein referred to as Ozark, Hutco Equipment Company, herein referred to as Hutco, and Mobilefreeze Company, Inc., herein referred to as Mobilefreeze, together constitute a single employer within the meaning of the Act. We further find, from the same record evidence, that Ozark, Hutco, and Mobilefreeze, during the critical period herein involved, functioned and operated as a single, integrated enterprise engaged principally in the manufacture, distribution, sale, and service of refrigerated truck bodies.

2. The Trial Examiner found that Respondents interfered with, restrained, and coerced the Ozark employees in violation of Section 8(a)(1), and discriminated against them in regard to their tenure of employment in violation of Section 8(a)(3) by locking out said employees on December 19, 1963, in retaliation for the Union's demand that certain dischargees be reinstated. However, the Trial Examiner found that Respondents' conduct in this regard was not violative of Section 8(a)(5) as alleged in the complaint. No exceptions were filed to these findings, and we hereby adopt them pro forma.

3. The Trial Examiner further found that the Respondents violated Section 8(a)(1) and (5) of the Act by closing the Ozark plant on March 1, 1964, without prior notice to, or consultation with, the employees' authorized representative at the Ozark Plant. We agree with this finding of the Trial Examiner.

¹ The complaint also contained an allegation that by terminating the employment of the employees at the Ozark plant on or before its final closing, and thereafter failing and refusing to reinstate them, Respondent also violated Section

As a result of a Board-conducted election held on March 1, 1963, at the Union was certified on March 11, 1963, as the exclusive bargaining representative of all the employees of Ozark, excluding office clerical employees, watchmen and guards, professional employees, the plant manager, and all other supervisors as defined in the Act. On April 16, 1963, Ozark and the Union executed a collective bargaining agreement for a term of 1 year, which provided for automatic renewal thereafter in absence of notice from either of the parties to the contrary. The contract continued in effect during the events set forth below.

Near the end of January 1964, Ozark's Board of Directors,³ for economic reasons, determined to close the Ozark plant located in Ozark, Missouri. Sometime prior to February 21, 1964, the plant manager of the Ozark plant, Holekamp, was informed that the plant was to be closed, but, apparently, he was not notified that the plant closing would be permanent.

At the time, there were four truck bodies nearing

⁸⁽a) (1) and (3) of the Act. The Trial Examiner found, however, on the basis of the record evidence, that Respondents' decision to close down the Ozark plant "was based primarily upon economic considerations," and that the General Counsel failed to demonstrate by a fair preponderance of the evidence that the decision was motivated to any appreciable extent by union animus or a desire to get rid of the Union. Accordingly, the Trial Examiner granted Respondents' motion to dismiss this particular 8(a)(3) allegation of the complaint. As no exceptions were filed to these findings or ruling of the Trial Examiner, we hereby adopt them pro forma.

² Case No. 17-RC-4042.

³ At the time, Henry Warren, Jr., John B. Latzer, Henry G. Drosten, and William B. Westfall served as Ozark's Board of Directors. In addition, Warren, Latzer, and Drosten were the principal stockholders of Ozark, Mobilefreeze, and Hutco, and also served as the Board of Directors of Mobilefreeze and Hutco.

completion in the plant. Thereafter, it appears that as each truck body was completed, employees no longer needed were laid off on a seniority basis. The first reduction in force occurred on February 20, 1964. At that time, Holekamp told Union steward Henry that the layoff was due to lack of work, that it was a temporary layoff, and that he could not promise when Henry would be recalled. It is clear that Henry was not informed that the plant was being closed permanently. On February 27, 1964, the office manager, and on the following day the remaining production employees were terminated. By March 1, 1964, the four truck bodies having been completed, the plant was closed. Thereafter, plant manager Holekamp was transferred to the Mobilefreeze plant in Parsons, Kansas, where he became manager of the truck body manufacturing operation in that plant. Most of the equipment located at the Ozark plant was then moved to the Mobilefreeze plant for storage.

The record shows that, prior to its shutdown, the Ozark plant was engaged almost exclusively in manufacturing refrigerated truck bodies for Mobilefreeze. Normally, the materials required for the manufacturing operation were ordered by Mobilefreeze and shipped to the Ozark plant. After the truck bodies were made at Ozark, they were returned to Mobilefreeze for distribution and sale. It also appears that in addition to the truck bodies made at the Ozark plant, other truck bodies were manufactured at the Mobilefreeze plant in Parsons, Kansas. However, the manufacturing operations at the Mobilefreeze plant did not increase substantially after the closing of the Ozark plant. Instead, it appears from the record that after the Ozark plant closed, Mobilefreeze there-

after contracted with Schodorf Body Company in Columbus, Ohio, for the manufacture of truck bodies.4

It is clear from the record evidence that the Ozark plant was closed and dismantled without notice to and without affording the Union an opportunity to bargain with respect to the effects of Respondent's decision upon the employees. In N.L.R.B. v. Royal Plating & Publishing Co., 350 F. 2d 191 (C.A. 3), the Court aptly described Respondents' obligation to notify and bargain with the Union over the effects of such a decision to close the plant in the following manner:

However, under circumstances such as those presented by the case at bar an employer is still under an obligation to notify the union of its intentions so that the union may be given an opportunity to bargain over the rights of the employees whose employment status will be altered by the managerial decision. N.L.R.B. v. Rapid Bindery, Inc., 293 F. 2d 170 (C.A. 2). See also N.L.R.B. v. Lewis, 246 F. 2d 886 (C.A. 9); Shamrock Dairy, Inc., 119 NLRB 998, 124 NLRB 494, enforced sub nom; International Brotherhood of Teamsters v. N.L.R.B., 280 F. 2d 665, (C.A. D.C.), cert. denied, 364 U.S. 892. Bargainable issues such as serverance pay, seniority and pensions, among others, are necessarily of particular relevance and importance. Cf. John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 554; Inland Steel Co. v. N.L.R.B., 170 F. 2d 247 (C.A. 7), cert. denied 336 U.S. 960; N.L.R.B. v. Westinghouse Air Brake Co., 120 F. 2d 1004 (C.A. 3).

There can be no doubt that Respondents, by withholding all information of their intention to close

⁴ It is not clear from the record whether the contract with Schodorf Body Company provided for the manufacture of the same type truck bodies previously manufactured at the Ozark plant.

down and terminate the operations at the Ozark plant, prevented the Union from bargaining over the effect of the plant closing on the employees. Moreover, in the circumstances of this case, we find no merit in Respondent's contention that it was not required to bargain with the Union because the Union failed to request bargaining "about the closing of Ozark." Indeed, the record evidence shows that the Union representatives were unaware of Respondents' decision to close the Ozark plant, and on February 20, when the Union steward sought information as to the duration of the layoff, Respondents' plant manager told him that the lavoff was due to lack of work and was only temporary in nature. It thus appears that the Union, during the most critical period, and at the very time when bargaining would have been most productive, was completely unaware of Respondents' intention to close the Ozark plant permanently. After so concealing its intentions from the Union, Respondent cannot now persuasively argue that it was not required to bargain with the Union because the Union did not request such bargaining. Accordingly, on the basis of the entire record, and for the reasons set forth above, we agree with the Trial Examiner's finding that Respondents violated Section 8(a)(5) and (1) of the Act by closing the Ozark plant and discharging all employees in the unit without consulting with the Union or giving it an opportunity to bargain over the effects of such closing on the employees.

We turn next to the more difficult issue, namely, whether Respondents also violated Section 8(a)(5) and (1) by bypassing the statutory bargaining representative of the employees at the Ozark plant and failing to bargain over the decision to close the plant permanently. The Trial examiner found that Re-

spondents did so violate the Act. We agree with the Trial Examiner in this regard for the following reasons:

At the outset, and as we have heretofore found, Respondents Ozark, Hutco, and Mobilefreeze, during the critical period herein involved, functioned and operated as a single, integrated, multiplant enterprise, engaged principally in the manufacture, sale, and service of refrigerated truck bodies. In these circumstances we must view the closing of the Ozark plant only as a partial closing of the Respondents' enterprise, and not a complete going out of a business by Respondents. Thus, we are not here confronted with the question whether a decision to go out of business completely is a mandatory subject of bargaining under Section 8(a)(5) of the Act. Accordingly, we need not, and do not, determine the impact on that question of the Supreme Court's holding in N.L.R.B. v. Darlington Mfg. Co., 380 U.S. 263. It is sufficient to note that that holding cannot be relevant to the issue before us which involves Respondents' duty to bargain about the partial closing of their business. We perceive nothing in that portion of the Darlington decision dealing with the discriminatory partial closing of a business which suggests the inapplicability of the collective-bargaining requirement of the Act to Respondents' decision to close down the Ozark plant. Indeed, as the *Darlington* decision affrms the propriety of the application of Section 8(a)(3) to a partial closing of a business, it would be anomalous to find that Section 8(a)(5) is without governing authority in such situations.6 We therefore find that the Darlington decision does not require dismissal of the complaint, and that the question of whether the

Royal Plating and Polishing Co., Inc., 152 NLRB 619, 622.
 Ibid.

Respondents violated the Act in unilaterally determining to close down the Ozark plant must be decided in the light of considerations set forth in the Supreme Court's decision in the Fibreboard case.⁷

In Fibreboard, the Supreme Court was faced with the question whether an employer's decision, motivated by economic considerations, to subcontract certain maintenance work performed by its employees, was covered by the phrase "terms and conditions of employment" within the meaning of Section 8(d) and was, accordingly, a matter about which the employer was obligated to bargain by virtue of Section 8(a) (5). In affirming our finding that subcontracting was a matter about which the employer must bargain, the Court commented (379 U.S. at 210):

The subject matter of the present dispute is well within the literal meaning of the phrase "terms and conditons of employment." See Order of Railroad Telegraphers v. Chicago & N.W.R. Co., 362 U.S. 300. A stipulation with respect to the contracting out of work performed by members of the bargaining unit might appropriately be called a "condition of employment." The words even more plainly cover termination of employment which, as the facts of this case indicate, necessarily results from the contracting out of work performed by members of the established bargaining unit.

So here, a termination of employment was the necessary result of Respondents' decision to close the Ozark plant. Thus here, just as in *Fibreboard*, Respondents have failed to bargain concerning a "term or condition of employment."

We recognize, of course, that the Supreme Court's decision in *Fibreboard* was limited to the type of contracting out involved in that case, and did not ex-

⁷ Fibreboard Paper Products Corp. v. N.L.R.B., 379 U.S. 203.

plicitly deal with the question whether an employer must bargain concerning a decision to terminate a portion of its operations. We further recognize that two Courts of Appeals have held, in reliance on the concurring opinion in Fibreboard, that a decision of this nature need not be bargained about. Thus, in N.L.R.B. v. Adams Dairy, Inc., 350 F. 2d 108, cert. denied, 382 U.S. 1011, the Court of Appeals for the Eighth Circuit held that a managerial decision to substitute independent contractors for employees in the distribution of the employer's products was outside the mandatory bargaining requirements of the Act on the ground that it involved a "basic operational change" and a "partial liquidation and a recoup of capital investment." Similarly, in N.L.R.B. v. Royal Plating & Polishing Co., 350 F. 2d 191, the Court of Appeals for the Third Circuit held that a decision to shut one of an employer's two plants involved a "management decision to recommit and reinvest funds in the business" and a "major change in the economic direction of the Company," and, accordingly, that the employer was under no duty to bargain with the union respecting that decision.

With all respect to the Courts of Appeals for the Third and Eighth Circuit, we do not believe that the question whether a particular management decision must be bargained about should turn on whether the decision involves the commitment of investment capital, or on whether it may be characterized as involving "major" or "basic" change in the nature of the employer's business. True it is that decisions of this nature are, by definition, of significance for the employer. It is equally true, however, and ought not

⁸ 350 F. 2d at 211. See also, N.L.R.B. v. Burns Detective Agency, 346 F. 2d 897 (C.A. 8).

^{9 350} F. 2d at 196.

be lost sight of, that an employer's decision to make a "major" change in the nature of his business, such as the termination of a portion thereof, is also of significance for those employees whose jobs will be lost by the termination. For, just as the employer has invested capital in the business, so the employee has invested years of his working life, accumulating seniority, accruing pension rights, and developing skills that may or may not be salable to another employer. And, just as the employer's interest in the protection of his capital investment is entitled to consideration in our interpretation of the Act, so too is the employee's interest in the protection of his livelihood. As the Supreme Court said in dealing with a not dissimilar question in Wiley v. Livingston, 376 U.S. 543, 549:

The objectives of national labor policy, reflected in established principles of federal law, require that the rightful prerogative of owners independently to rearrange their businesses and even eliminate themselves as employers be balanced by some protection to the employees from a sudden change in the employment relationship....

In short, we see no reason why employees should be denied the right to bargain about a decision directly affecting terms and conditions of employment which is of profound significance for them solely because that decision is also a significant one for management. Nor we do believe that the rationale which underlies both our decision in *Fibreboard* and the Supreme Court's decision in that case compels such a limitation. It was our view in *Fibreboard*, and the view of the Supreme Court, as we read the Court's opinion therein, that bargaining about contracting out might appropriately be required because to do so effectuated one of the primary purposes of the Act—"to promote

the peaceful settlement of industrial disputes by subjecting labor-management controversies to the mediatory influence of negotiation." 10 The Court there continued (ibid):

> To hold, as the Board has done, that contracting out is a mandatory subject of collective bargaining would promote the fundamental purpose of the Act by bringing a problem of vital concern to labor and management within the framework established by Congress as most conducive to industrial peace.

We think it plain the same may be said about a management decision to terminate a portion of the enterprise—termination, just as contracting out, is a problem of vital concern to both labor and management, and it would promote the fundamental purpose of the Act to bring that problem within the collective bargaining framework set out in the Act.

There is yet another significant respect in which the management decision involved in the instant case is similar to that in Fibreboard and ought also be the subject of collective bargaining. In Fibreboard, the Court noted that the factors which underlay the employer's decision to contract out were primarily related to the cost of labor (size of the work force, fringe benefits, overtime payments) and that these matters had long been regarded as "peculiarly suitable for resolution within the collective bargaining framework".11 In the instant case the factors relied upon by Respondents as justifying their decision to close the Ozark plant were (as set out in Ozark's answer to the complaint): excessive man hours were required for the production of custom refrigerated truck bodies; the truck bodies produced and sold

^{10 379} U.S. at 211.

¹¹ 379 U.S. at 213-214.

would not perform properly because of defective workmanship, necessitating a return of the bodies to the plant at disastrous expense to Respondents; and the plant facilities were not efficiently laid out. At least the first two of these-rate and quality of production—are traditional subjects of collective bargaining and would appear as susceptible of resolution within the collective-bargaining framework as the labor cost issues involved in Fibreboard. A decision to contract out the work performed at the Ozark plant, if substantially predicated on these factors would surely, under the rationale of Fibreboard, be subject to the bargaining requirements of the Act; we see no reason why a decision to close the Ozark plant, predicated on the same considerations, ought not be equally subject to those bargaining requirements.

The argument has been made that to compel an employer to bargain about a decision to relocate or terminate a portion of his business would significantly abridge his freedom to manage the business. In the first place, however, as we have pointed out time and again,12 an employer's obligation to bargain does not include the obligation to agree, but solely to engage in a full and frank discussion with the collective-bargaining representative in which a bona fide effort will be made to explore possible alternatives, if any, that may achieve a mutually satisfactory accommodation of the interests of both the employer and the employees. If such efforts fail, the employer is wholly free to make and effectuate his decision. Hence, to compel an employer to bargain is not to deprive him of the freedom to manage his business.

But, it has been argued, imposing the obligation to bargain, which includes a requirement that the bar-

¹² See, e.g., Town & Country Mfg. Co., 136 NLRB 1022, 1027, enfd. 316 F. 2d 846 (C.A. 5).

gaining be in good faith, and which precludes unilateral action absent sufficient bargaining,13 all subject to the surveillance of this Board, and ultimately of the courts, so impedes management flexibility in meeting business opportunities and exigencies that the statute ought not be interpreted to require such bargaining. As to this, however, the answers are plain. Initially, Congress made the basic policy determination, in enacting the National Labor Relations Act, that, despite management's interest in absolute freedom to run the business as it sees fit, the interests of employees are of sufficient importance that their representatives ought be consulted in matters affecting them, and that the public interest, which includes the interests of both employers and employees, is best served by subjecting problems between labor and management to the mediating influence of collective bargaining.

Secondly, the Supreme Court held in Fibreboard, affirming our decision therein, that such limitations on absolute freedom to manage the business as are inherent in compelling bargaining on contracting out are justified by the potential gains of requiring bargaining. If this is true with respect to decisions regarding contracting out, we think it is a fortiori true with respect to decisions regarding the relocation or termination of a portion of the business. Decisions as to contracting out are not infrequent. To require bargaining as to such decisions does arguably impose certain constraints on management in the normal operation of the enterprise (ameliorated, of course, by management's freedom to negotiate arrangements concerning the future contracting out of work as the need arises). Yet, it is plain, bargaining over contracting out is required. Decisions whether to relo-

¹³ See Shell Oil Co., 149 NLRB 305.

cate or terminate a portion of the business surely arise with less frequency in the life of the typical corporate enterprise than decisions whether to contract out certain work. Indeed, such decisions are extremely rare for most employers. Hence, to require bargaining over these decisions appears, if anvthing, less of a limitation on management flexibility in running the business than to require bargaining about contracting out. Accordingly, we think it no significant intrusion on management freedom to run the business to require that an employer—once he has reached the point of thinking seriously about taking such an extraordinary step as relocating or terminating a portion of the business—discuss that step with the bargaining representative of the employees who will be affected by his decision. Furthermore, such limitation on absolute employer freedom as is involved in imposing a bargaining requirement is amply justified by the interest of the employees in being consulted about a decision with profound impact on them, and by the public interest in industrial peace. Cf. Wiley v. Livingston, 376 U.S. 543, 549.

It has been contended,¹⁴ however, that issues of contracting out, plant removal or shut-down are impossible of resolution by collective bargaining, that there is an irreconcilable conflict between the demands which bargaining representatives are compelled—by internal political necessities—to make, on the one hand, and the competitive and managerial necessities which employers are compelled to follow, on the other. Hence, it is urged, these matters must by a narrow construction of the law be committed to the sole discretion of employers as an unconditional management prerogative.

¹⁴ See, e.g., F. A. O'Connell, 'New Ferment in Labor Relations'—Employer View, 61 LRR 110.

The conduct and experience of a growing number of employers and unions ¹⁵ attest to the complexity and difficulty of such problems, but prove, contrary to the above claim, that they can be and are resolved, and support the rationale of our decisions that such matters properly come within the scope of the bargaining obligation under the Act.

Thus, a Bureau of Labor Statistics study of 1687 major collective bargaining agreements in effect at the beginning of 1959 shows that there were 378 with express limitations on contracting out work that might otherwise be available to employees in the bargaining unit.16 Again, a study of bargaining in 74 plants relating to contracting out by Professor Margaret K. Chandler, 17 showed that 32 percent had collectivebargaining contracts with clauses governing contracting out. Reflecting the growing number of cases in which mutual discussions have even succeeded in averting shut-downs is an article in the Wall Street Journal, June 10, 1964, describing a number of situations in which unions accepted cuts in wages and fringe benefits to save employee jobs threatened by proposed plant relocation or closure.18 In short, bar-

it is appropriate to look to industrial bargaining practices in appraising the propriety of including a particular subject within the scope of mandatory bargaining"). See also, *Telegraphers* v. *Railway Express Agency*, 321 U.S. 342, 346; Cox and Dunlop, *Regulation of Collective Bargaining by the National Labor Relations Board*, 63 Harv. L. Rev. 389, 405–406.

¹⁶ Fibreboard, supra, at 212, footnote 7.

¹⁷ Chandler, Management Rights and Union Interests, p. 217. (1964).

¹⁸ See, also, *Business Week*, February 29, 1964 (Company agrees to retain plant in Philadelphia in return for union acquiescence in changed work rules); Oswald, *Easing Job Changes by Advance Notice*, AFL-CIO Federationist, Dec. 1965, p. 13; Seidman, *The Union Agenda for Security*, 86 Monthly Labor Review 636, 640 (1963).

gaining about plant removal and shutdown, albeit not as widespread as bargaining about contracting out (perhaps because of the greater frequency with which the latter problem arises), does take place and need not be futile. Under these circumstances, we see no justification for interpreting the statutory bargaining obligation so narrowly as to exclude plant removal and shutdown from its scope.

Finally, while meaningful bargaining over the effects of a decision to close one plant may in the circumstances of a particular case be all that the employees' representative can actually achieve, especially where the economic factors guiding the management decision to close or to move or to subcontract are so compelling that employee concessions cannot possibly alter the cost situation, nevertheless in other cases the effects are so inextricably interwoven with the decision itself that bargaining limited to effects will not be meaningful if it must be carried on within a framework of a decision which cannot be revised. An interpretation of the law which carries the obligation to "effects", therefore, cannot well stop short of the decision itself which directly affects "terms and conditions of employment".

The Remedy

While the Trial Examiner correctly found that Respondent violated the Act in failing to bargain with the Union over the closing of the Ozark plant, by way of remedy, he ordered, inter alia, backpay for the employees until one of the following conditions occurred: (1) reaching mutual agreement with the Union relating to the subjects which the Respondents are hereby required to bargain about; (2) bargaining to a genuine impasse; (3) the failure of the Union to commence negotiations within 5 days of the receipt of

the Respondents' notice of their desire to bargain with the Union; or (4) the failure of the Union to bargain thereafter in good faith. We agree that backpay is appropriate under the facts in this case, but we do not agree with the Trial Examiner that backpay liability is to continue until one of the above conditions occur.

The Board has indicated that backpay orders are appropriate means of remedying 8(a)(5) violations of the type involved herein, even where such violations are unaccompanied by a discriminatory shutdown of operations.19 In fashioning remedies the Board bears in mind that the remedy should be adapted to the situation that calls for redress,20 with a view toward "restoring the situation as nearly as possible, to that which would have obtained but for [the unfair labor practice]." 21 Here, the unfair labor practice was the unilateral close-down of the Ozark plant without giving the Union notice or opportunity to discuss the decision to close down and matters that would affect the employees involved. The nature of the violations would justify directing the Respondents to restore the situation existing prior to the closedown of the Ozark operation by reestablishing the discontinued operation. But this appears impractical as the plant has been shut down for a considerable period of time and the machinery has been shipped some distance away.²² Further, we down the Ozark operation was prompted solely by are satisfied that the Respondents' decision to close

¹⁹ Royal Plating and Polishing Co., Inc., 148 NLRB 545, and cases cited therein at footnote 7.

²⁰ N.L.R.B. v. Mackay Radio & Telegraph Co., 304 U.S. 333.

²¹ Phelps-Dodge Corp. v. N.L.R.B., 313 U.S. 177, 194.

²² See N.L.R.B. v. American Mfg. Co. of Texas, 351 F. 2d 74 (C.A. 5).

pressing economic necessity.23 However, if we are to effectuate the policies of the Act and achieve responsible collective bargaining, it is essential that a backpay remedy be ordered, one that fits the circumstances of this case. We think the Trial Examiner's recommendation as to the time that backpay should cease, that is the occurrence of one of the aforementioned conditions, is too speculative. Accordingly, we shall order the Respondent to make whole the emplovees for any loss of pay suffered by them as a result of the Respondents' unlawful refusal to bargain from the time they made the decision to close the plant at the end of January 1964, to the date the Ozark plant was closed on March 1, 1964, by paving to each of them a sum of money equal to the amount each would have earned as wages from the date of his termination during that period until the Ozark plant was closed. Backpay shall be based upon the earnings which the terminated employees would normally have received during the applicable period less any net interim earnings, and shall be computed on a quarterly basis in the manner set forth in F. W. Woolworth Company, 90 NLRB 289; N.L.R.B. v. Seven-Up Bottling Company of Miami, Inc., 344 U.S. 344; with interest thereon, Isis Plumbing and Heating Company, 138 NLRB 716.

Order

Pursuant to Section 10(c) of the National Labor Relations Act, as amended, the National Labor Relations Board adopts as its Order the Recommended Order of the Trial Examiner, as modified below, and hereby orders that the Respondents, Ozark Trailers, Incorporated, Ozark, Missouri, Hutco Equipment Company, Springfield, Missouri, and Mobilefreeze,

²³ See Renton News Record, etc., 136 NLRB 1294.

Inc., Parsons, Kansas, their officers, agents, successors, and assigns, shall take the action set forth in the Trial Examiner's Recommendations, as herein modified:

1. Amend paragraph 1(b) of the Trial Examiner's Recommended Order by deleting therefrom subparagraph (b) and inserting in lieu thereof the following:

"(b) Failing and refusing to bargain collectively with International Union, Allied Industrial Workers of America, Local No. 770, AFL-CIO, as the exclusive representative of their Ozark plant employees, concerning the decision to close the Ozark plant and the effects of the discontinuance of their Ozark plant operations on such employees."

2. Add to the Trial Examiner's Recommendations

as subparagraph 1(c) the following:

"(c) Unilaterally closing down any of their plants without prior notice to and bargaining with the collective-bargaining representative or representatives, if any, of employees in such plant concerning the decision to close down and its effects."

- 3. Renumber the present subparagraph 1(c) to 1(d).
- 4. Paragraph 2(c) is amended by changing the period appearing at the end of the paragraph to a comma, and by adding the words "as modified by the section entitled 'Remedy' of the Board's Decision and Order."
- 5. Amend the Notice attached as an Appendix to the Trial Examiner's Decision by deleting therefrom the second indented paragraph on page (1) and insert therein the following two paragraphs:

WE WILL NOT fail and refuse to bargain collectively with International Union, Allied Industrial Workers of America, Local No. 770, AFL-CIO, as the exclusive representative of

our Ozark plant employees, concerning the decision to close the Ozark plant and the effects of the discontinuance of our Ozark plant op-

erations on such employees."

WE WILL NOT unilaterally close down any of our plants without prior notice to and bargaining with the collective-bargaining representative or representatives, if any, of employees in such plant concerning the decision to close down and its effects.

Amend the first full paragraph on page (ii) of the Appendix by changing the period appearing at the end of the paragraph to a comma, and by adding the words "as modified by the section entitled 'Remedy' of the Board's Decision and Order.'

Dated, Washington, D.C.

FRANK W. McCulloch,

Chairman,

JOHN H. FANNING,

Member.

GERALD A. BROWN,

Member.

Sam Zagoria,

Member.

[SEAL] National Labor Relations Board.

No. 20,966 V

IN THE

United States Court of Appeals For the Ninth Circuit

RICHARD L. CHARTRAND,

Appellant,

VS.

Barney's Club, Inc., a Nevada corporation,

Appellee.

Appeal from the United States District Court for the District of Nevada

APPELLANT'S BRIEF

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FILED

AUG 26 1966

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WM. B. LUCK, CLERK



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IN THE

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Appellee.

Appeal from the United States District Court for the District of Nevada

APPELLANT'S BRIEF

STATEMENT OF PLEADINGS AND FACTS DISCLOSING JURISDICTION

Complaint was filed by Barney's Club, Inc., plaintiff against Richard L. Chartrand, defendant, in the Second Judicial District Court, State of Nevada, In and for the County of Washoe. At said time defendant Chartrand was a resident of and domiciled in the State of California, while plaintiff Barney's Club, Inc. is a Nevada corporation, incorporated in August of 1960. The substance of the complaint was to compel the specific performance of an alleged agreement whereby defendant would transfer 240 shares of Barney's Club, Inc. stock, and all interest (which was disputed) in an additional 15 shares, in return for

\$200,000. A counterclaim was filed by Chartrand seeking specific performance of a pre-incorporation contract, whereby plaintiff would issue to defendant an additional 15 shares of capital stock, the value of which is over \$10,000.

Upon petition of the defendant (T 2-3) and exhibits attached thereto (T 4-49) the matter was removed to Federal District Court, District of Nevada, pursuant to 28 U.S.C. § 1332, on the basis of diversity of citizenship and that the matter in controversy exceeded the sum of \$10,000. The plaintiff on motion moved for the dismissal of its complaint for specific performance of its alleged agreement with prejudice and the court so ordered. (T 86) The case was thereafter tried in the District Court upon the counterclaim of Chartrand and judgment was rendered against Chartrand and his request for specific performance was denied. (T 72)

The appeal is taken as a matter of right under the provision of 28~U.S.C. § 1291, being an appeal from a final decision of a federal district court.

STATEMENT OF FACTS

This action came on for trial before the Court, sitting without a jury, on November 23 and November 24, 1965, on the issues made by defendant's counterclaim and plaintiff's reply thereto and on December 29, 1965, the Court entered its Findings of Fact, Conclusions of Law and Judgment as follows:

"FINDINGS OF FACT

- 1. At the time of the commencement of this action and at the time of the removal of this action from the Second Judicial District Court of the State of Nevada, in and for the County of Washoe, to the United States District Court for the District of Nevada, plaintiff, Barney's Club, Inc., was a corporation duly organized and existing under and by virtue of the laws of the State of Nevada, with its principal place of business in the State of Nevada; and defendant, Richard L. Chartrand, was a citizen of the State of California. The amount in controversy exceeds the sum of \$10,000, exclusive of interest and costs. Barney's Club, Inc. was incorporated in August, 1960." (T 67)
- "2. In the Summer of 1960, and prior to the incorporation of Barney's Club, Inc., Barney E. O'Malia and Richard L. Chartrand entered into an agreement contemplating the incorporation of Barney's Club, Inc. whereby each of them agreed to contribute \$80,000 as an investment in the proposed operation of a casino at Stateline, Nevada, to be known as Barney's Club, and that each of them would receive therefor an equal interest in 51%, or more of the corporation. By virtue of said agreement, defendant was entitled to a 25½% interest in the business." (T 68)
- "3. Thereafter, O'Malia made a down payment for real property at Stateline, Nevada, which was subsequently conveyed to the corporation, and paid in monies to the corporation in the total amount of \$70,000 and contributed services and made expenditures on behalf of the corporation of the claimed value of \$10,000." (T 68)

"4. In November, 1960, Chartrand made his first payment of money to the corporation, and thereafter made additional payments, the last of which, in the sum of \$30,000, was made in April, 1961. Chartrand paid a total amount of \$80,000 in cash to the corporation." (T 68)

"5. On February 1, 1961, Chartrand made, executed and delivered to the Gaming Control Board of the State of Nevada an Invested Capital Questionnaire signed and sworn to by him in which he claimed a 24% percentage interest in the operation of Barney's Club, Inc. Said document was filed concurrently with an application for a state gaming license made by B. E. O'Malia, as President of Barney's Club, Inc., in which, among the individuals listed as being interested in the operation, was C & O Investment Co., Inc., with a 51% investment in Barney's Club, Inc., parceled among Richard L. Chartrand, 45%; Bernard E. O'Malia, 45%; William F. O'Malia, 5%; and Frances L. O'Malia, 5%, which, derivatively, asserted a 24% interest to Richard L. Chartrand in Barney's Club, Inc. At that time, Chartrand and O'Malia contemplated the incorporation of C & O Investment Co., Inc. to hold their stock interests in Barney's Club, Inc., and Articles of Incorporation for C & O Investment Co., Inc. were filed on March 14, 1961. Said corporation was never fully organized or activated. Thereafter, and on April 11, 1961, Bernard E. O'Malia and Richard L. Chartrand jointly directed a letter to the Gaming Control Board of Nevada, as follows:

'Permission is hereby requested to delete that portion of the application filed February 13, 1961, which reads C & O Investment Co., Inc.

'This corporation will not be formed as contemplated and the applicants will become stockholders in Barney's Club, Inc., dba Barney's Club with beneficial ownership in the latter corporation in the same percentage as they would have held had the C & O Investment Company been incorporated.'" (T 68-69)

"6. In February and March, 1961, the Board of Directors of Barney's Club, Inc. was comprised of Barney E. O'Malia, Frances O'Malia, his wife, and William F. O'Malia, his son. On February 17, 1961, the Board of Directors adopted a resolution approving the issuance of 510 shares of the capital stock of the corporation to C & O Investment Co., Inc. On March 20, 1961, the Board of Directors adopted a resolution rescinding the resolution adopted February 17, 1961, and approving the issuance of capital stock of the corporation as follows: Barney E. O'Malia, 240 shares; Richard Chartrand, 240 shares; Frances O'Malia, 15 shares; William F. O'Malia, 15 shares.

The foregoing are the only corporate minutes relevant to the stock entitlement of Chartrand before a dispute arose with respect thereto. There are no organization minutes recording the corporation's obligation at the time the real property at Stateline, Nevada, acquired for the use of the corporation, was deeded to the corporation." (T 69-70)

"7. Capital stock of the corporation has been issued in accordance with the resolution adopted by the Board of Directors at its meeting on March 20, 1961. Since June, 1961, Chartrand has repeatedly demanded an additional fifteen shares of the capital stock to the end that he

would have received 255 shares, representing 25½% of the total authorized capital stock in accordance with his pre-incorporation agreement with O'Malia." (T 70)

"8. Barney's Club, Inc. now has 20 shares of Treasury Stock and is able to comply with Chartrand's demand for an additional 15 shares." (T 70)

"CONCLUSIONS OF LAW

Insofar as the following Conclusions of Law may be considered findings of fact, and insofar as facts are included in the Conclusions of Law which are not included in the foregoing Findings of Fact, the Court finds such facts to be true in all respects.

- 1. Prior to incorporation, the promoters of a proposed corporation can act only for themselves and are not agents for the then non-existent corporate entity. Absent an express or implied adoption of a pre-incorporation contract made by a promoter, the corporation is not liable thereon." (T 70)
- "2. An adoption of a pre-incorporation agreement may be implied if the evidence shows that the corporation accepted the benefit of the agreement, with knowledge thereof and with the inferred intent that it be bound thereby." (T 71)
- "3. There is no credible evidence that Barney's Club, Inc., a corporation, ever assumed or intended to be bound by the pre-incorporation agreement to the effect that O'Malia and Chartrand each receive 25½% of the authorized capital stock of the corporation." (T 71)

- "4. The minutes of meetings of the Board of Directors of Barney's Club, Inc. would not be of much evidentiary weight inasmuch as the Board was then composed of O'Malia and members of his immediate family, if the resolutions of the Board then adopted were not corroborated by actions taken in implementation thereof in which Chartrand participated with respect to the applications to the Nevada Gaming Control Board for a gaming license. After the adoption of such resolutions, the applications to the Gaming Control Board and the issuance of stock conformably with the resolution adopted on March 20, 1961, Chartrand paid to the corporation the final installment (\$30,000) of his \$80,000 pre-incorporation subscription agreement." (T 71)
- "5. The foregoing, in summary, is the most persuasive evidence adduced relevant to the responsibility of the corporation for the issuance of shares of its capital stock to O'Malia and Chartrand, respectively." (T 71)
- "6. The burden of proof is upon Chartrand to establish that Barney's Club, Inc., a corporation, adopted the pre-incorporation agreement between O'Malia and Chartrand with respect to Chartrand's entitlement to 255 shares of the corporate stock." (T 71)
- "7. The evidence hereinabove related creates a substantial uncertainty regarding whether the corporation received monies from Chartrand with knowledge of the pre-incorporation agreement, or whether the corporation adopted such agreement. Chartrand has not sustained the burden of proof in that respect." (T 71-72)

"8. Richard L. Chartrand is not entitled to the issuance to him of an additional 15 shares of the capital stock of Barney's Club, Inc. by reason of the transactions referred to in the evidence and summarized in the foregoing Findings of Fact." (T 72)

JUDGMENT

"IT HEREBY IS ORDERED, ADJUDGED AND DECREED that defendant, Richard L. Chartrand, take nothing by virtue of the counterclaim filed by him praying for the issuance to him of an additional fifteen shares of the capital stock of Barney's Club, Inc.

Dated: December 28, 1965.

Bruce R. Thompson United States District Judge"

(T72)

Thereafter on the 10th day of January, 1966, the defendant Chartrand made a Motion to the Court for a new trial and/or to vacate judgment and Motion to make additional Finding of Fact (T 73-85) and subsequently the Court by order (T 87-89) on February 8, 1966, amended the Conclusion of Law and Finding of Fact No. 7 on pages 5 and 6 of the judgment filed December 29, 1966, to read as follows:

"7. The knowledge of Bernard E. O'Malia concerning the terms of the pre-incorporation agreement between O'Malia and Chartrand should be imputed to the corporation, and the plaintiff corporation, at all times pertinent, had knowledge of such agreement. The evidence hereinabove related creates a substantial uncertainty regarding whether plaintiff corporation adopted such agree-

ment. Chartrand has not sustained the burden of proof in that respect and the credible evidence refutes the inference of adoption which would otherwise be justified from acceptance of benefits with knowledge of the agreement." (T 89)

Thereafter on the 9th day of March, 1966, Notice of Appeal and Bond were filed by Chartrand (T 90-91) and the case is before this Court upon such appeal.

ERROR CHARGED

The trial court erred in holding as a matter of law that even though the knowledge of O'Malia, who was a party to the pre-incorporation agreement, was imputed to the corporation, which also accepted the benefits thereof, that the corporation did not adopt the contract but only created an "inference" of adoption.

The Court should have found as a matter of law that the corporation was liable on the contract and be instructed to issue the additional 15 shares and all incidents thereof to appellant, pursuant to the preincorporation contract.

SUMMARY OF ARGUMENT

The defendant Chartrand is entitled to a decree of specific performance against the plaintiff Barney's Club, Inc. and the delivery of 15 additional shares of capital stock of the corporation for the following reasons:

The Court found as a fact that there was a preincorporation agreement between Chartrand and O'Malia that provided each would contribute \$80,000 in cash for 255 shares each of capital stock of Barnev's Club, Inc. That subsequently O'Malia became the President and guiding spirit of the corporation and a member of the Board of Directors and his wife and son the remaining members of the Board and its officers. That Barney O'Malia received in excess of 255 shares, or 251/2% of the capital stock of Barney's Club, Inc., pursuant to the pre-incorporation agreement, 240 shares were taken in Barney O'Malia's name and 30 shares were taken by his nominees, Frances, his wife, and William, his son. Chartrand paid \$80,000 in cash to the corporation which was accepted by the corporation with knowledge of the agreement and he received 240 shares of stock therefor but always protested that he was entitled to an additional 15 shares.

The contract was one that the corporation could lawfully make and it accepted the benefits of this contract with knowledge of the contract and cannot now avoid its burdens and the defendant is entitled to full performance of the pre-incorporation agreement and the 15 additional shares of stock and all incidents thereto. Further, that there are 20 shares of stock in the treasury of Barney's Club, Inc.

From the findings of fact made by the Court the burden of proof was sustained by the defendant and the Court erred as a matter of law in not decreeing specific performance of the pre-incorporation contract to Chartrand.

ARGUMENT

IS A CORPORATION BOUND BY A PRE-INCORPORATION AGREEMENT CONTRACTED BY THE PROMOTER WHERE THE PROMOTER UPON INCORPORATION BECAME THE PRESIDENT AND TOGETHER WITH HIS WIFE AND SON, THE ENTIRE BOARD OF DIRECTORS, THUS IMPUTING KNOWLEDGE OF THE TERMS OF THE CONTRACT TO THE CORPORATION, WHICH THEREAFTER ACCEPTED ITS BENEFITS?

Chartrand and O'Malia, promoters of Barney's Club, Inc. entered into a pre-incorporation agreement whereby each would invest \$80,000 in the corporation, and each would receive an equal share of 51% or 25½% in the stock of the corporation. Finding of Fact No. 2. (T 68)

The Court below has held in its Conclusions of Law and additional Finding of Fact No. 7 amended, that the knowledge of O'Malia as to the terms of the contract has been imputed to the corporation and that at all times pertinent the corporation had knowledge of the agreement. (T 89)

The Court also found that Chartrand paid into the corporation, after its incorporation, the \$80,000 agreed upon in the pre-incorporation contract. Finding of Fact No. 4 (T 68) Conclusions of Law No. 4 (T 71). The Court found that adoption of the contract by the corporation may be implied where the corporation has accepted the benefits of the agreement with knowledge of its terms. Conclusion of Law No. 2 (T 71) But the Court found that the corporation has not adopted the agreement because it did not find credible evidence that Barney's Club, Inc. had ever assumed or intended to be bound by the agreement. Conclusion of Law No. 3 (T 71)

PROMOTERS OR PERSONS WHO CONTEMPLATE ORGANIZING A CORPORATION, CAN MAKE CONTRACTS WHICH WILL BIND THE CORPORATION AFTER IT BECOMES A LEGAL ENTITY.

It may be assumed as true that promoters and incorporators have no standing in any relation of agency, since that which has no existence can have no agent, and, in the absence of any act authorizing them so to do, can enter into no contract, nor transact any business, which shall bind the proposed corporation after it becomes a distinct entity; but, notwithstanding this to be true, still such promoters and incorporators may, acting in their individual capacities, make contracts in furtherance of the incorporation, and for its benefit, and, after the incorporation comes into being as an artificial person under the forms of law, it may, at least under the weight of American authority, accept and adopt such contracts, and thereupon they become its own contracts, and may be enforced by or against it. This the corporation may do, not because of an agency, on the part of the incorporators, before the existence of the entity, for there is none, but because of its own inherent powers as a body corporate to make contracts. Wall v. Niagara Mining & Smelting Co. of Idaho, 20 Utah 474, 59 P. 399; H. Horowitz v. Weehawken Trust & Title Co., 10 N.J. Mis. R. 417, 159 A. 384.

This is especially true when the acts of promoters are made with incorporation in mind and that the acts are in furtherance of the corporate purpose and the corporation actually comes into existence. *Brace* v. Oil Fields Corporation, 173 Ark. 1128, 293 S.W.

1041; New England Oil Refining Co., et al. v. Wiltsee, 3 F.2d 424.

The courts have generally held corporations to be liable on contracts of the promoters on the theory of ratification, novation, adoption or a continuing offer to be accepted or rejected by the corporation when it comes into being and upon acceptance becomes a contract on its part. Liabilities have also been sustained on the ground that the corporation by accepting the benefits of a contract takes it *cum onere* and is estopped to deny its liability thereon. 123 A.L.R. 726, 728.

This principle is well settled in Nevada. Alexander v. Winters, 23 Nev. 475, 49 P. 116, rehearing denied 24 Nev. 143, 50 P. 798.

THE CONTRACT MUST NOT BE ULTRA VIRES BUT MUST BE LEGAL AND ONE THAT THE CORPORATION HAS THE AUTHORITY TO MAKE.

Promoter's contract becomes corporation's contract if it expressly or impliedly ratified or adopted after incorporation if within its charter powers. H. Horowitz v. Weehawken Trust & Title Co., 10 N.J. Mis. R. 417, 159 A. 384; Harris Tourist Bed Co. v. Whitbeck, 147 Okla. 109, 294 P. 800.

Nevada Revised Statutes 78.210 provies as follows:

"1. Any corporation existing under any law of this state may issue stock for labor, services, or personal property, or real estate or leases thereof. The judgment of the directors as to the value of such labor, services, property, real estate or leases thereof, shall be conclusive as to all except the then existing stockholders and creditors, and as to the then existing stockholders and creditors it shall be conclusive in the absence of actual fraud in the transaction.

2. Any and all shares issued for the consideration prescribed or fixed, in accordance with the provisions of this section shall be fully paid."

WHERE THE CORPORATION KNOWS OF THE TERMS OF THE AGREEMENT AND ACCEPTS THE BENEFITS THEREOF, IT HAS IMPLIEDLY ADOPTED THE PREINCORPORATION AGREEMENT AS ITS OWN, AND MUST BEAR THE BURDENS AS WELL AS THE BENEFITS OF THE CONTRACT.

Typical of the holdings of courts in this regard is this statement in Wall v. Niagara Mining de Smelting Co. of Idaho, 20 Utah 474, 475, 59 P. 399, 400:

". . . (P)romoters and incorporators may, acting in their individual capacities, make contracts in furtherance of the incorporation, and for its benefit, and, after the incorporation comes into being as an artificial person under the forms of law, it may, at least under the weight of American authority, accept and adopt such contracts, and may be enforced by or against it."

Other cases holding squarely in this point are: H. Horowitz v. Weehawken Trust & Title Co., 10 N.J. Mis. R. 417, 159 A. 384; New England Oil Refining Co., et al. v. Wiltsee (1st Cir.), 3 F.2d 424; Harris Tourist Bed Company et al. v. Whitbeck, 147 Okla. 109, 294 P. 800; Morgan v. Bon Bon Co., 222 N.Y. 22, 118 N.E. 205; Conway v. Marachowsky et al., 260 Wis. 540, 55 N.W.2d 909; Lowther v. Blair Distilling Co., 266 Ky. 428, 99 S.W.2d 204; Taylor Engines v. All Steel Engines (9th Cir.), 192 F.2d 171. See also collection of cases in 18 Am. Jur.2d, Corporations, § 122 p. 664, note 3. This rule is affirmed in Alexander v. Winters, 23 Nev. 475, 49 Pac. 116, rehearing denied 24 Nev. 143, 50 P. 798, in which the Court states:

"The liability does not rest upon any supposed agency of the promoters, but upon the immediate and voluntary act of the corporation. If the contract is within the corporate powers, the corporation may, when organized, expressly or impliedly, assume the responsibility of the same, and thus make it a valid obligation of the company. This is especially true if the agreement appears to be a reasonable means of carrying out any of the corporate powers or authorized purposes."

The rule stated in Murry v. Monter et al., 90 Utah 105, 107, 60 P.2d 960, 962, the only case cited by the court below in its Order on defendant's Motion for a New Trial and/or to Vacate Judgment and Motion to Make Additional Finding of Fact (T 89), is as follows:

"The rule is quite uniform that if a corporation with knowledge of a contract accepts the benefits thereof it will be required to perform the obligations. *Gardiner v. Equitable Office Bldg. Corp.* (C.C.A.) 273 F. 441, 17 A.L.R. 431."

NO FORMAL RATIFICATION OR ADOPTION IS NECESSARY TO BIND THE CORPORATION.

The court below in its Conclusions of Law and Additional Finding of Fact No. 7 amended, states:

"The knowledge of Bernard E. O'Malia concerning the terms of the pre-incorporation agreement between O'Malia and Chartrand should be imputed to the corporation, and the plaintiff corporation, at all times pertinent, had knowledge of such agreement. The evidence hereinabove related creates a substantial uncertainty regarding whether plaintiff corporation adopted such agreement. Chartrand has not sustained the burden of proof in that respect and the credible evidence refutes the inference of adoption which would otherwise be justified from acceptance of benefits with knowledge of the agreement." (T 89)

The trial court in spite of its express finding that full knowledge of the pre-incorporation agreement was imputed to the corporation (T 89) and its further finding that Chartrand had fully performed thereunder by the payment of \$80,000 to the corporation, Finding of Fact No. 4 (T 68), which accepted the money without reservation apparently held that these facts created only an "inference" of corporate acceptance (T 89), rather than the direct proof of acceptance by the corporation. In this appellant urges the trial court erred.

It is well settled that under these circumstances the acceptance by the corporation of the benefits of a pre-incorporation agreement with knowledge of its terms creates a binding and enforceable agreement between the corporation and the other party to the contract. No formal ratification, adoption or acceptance is necessary. Wall v. Niagara Mining & Smelting Co. of Idaho, 20 Utah 474, 59 P. 399; Seymour v. Association, 144 N.Y. 333, 39 N.E. 365, 26 L.R.A. 859; Graham v. First National Bank of Dickinson, 175 F. Supp. 81; In Re Super Trading Co., 22 F.2d 480.

The rule as followed in Nevada in Alexander v. Winter, 23 Nev. 485, cogently states:

"It is a well-settled proposition of law that a corporation may ratify an agreement made by its promoters. Such ratification may be implied from the acts of the corporation without an express acceptance.

The liability of the corporation under these circumstances does not rest upon a supposed agency of the promoters, but upon the immediate and voluntary act of the company. If the contract is within the corporate powers of the corporation, it may, when organized expressly or impliedly assume the responsibility of the same, and thus make it a valid obligation of the corporation. This is especially true if the agreement appears to be a reasonable means of carrying out any of the corporate powers or authorized purposes . . ." (Citing many authorities.)

The case of Murry v. Monter et al., 90 Utah 105, 107, 60 P.2d 960, 962, cited by the trial judge in his order to vacate the judgment, new trial and for additional findings of fact (T 89) as apparent authority for the trial court's decision, does not state a contrary

principle. In fact the case is in full accord with the authorities herein set forth. In *Murry*, Supra, the Court states at 60 P.2d 962:

"The rule is succinctly stated in 4 Cook on Corps. (8th Ed.), § 707, p. 2894 'A corporation accepting the benefits of the contract of its incorporators must accept the burden, and a promoter's contract which has been ratified or adopted by the corporation, or the benefits of which have been accepted by the corporation with knowledge of such contract, may be enforced against it." (Emphasis added)

Therefore, by the express findings of the trial court the agreement sought to be enforced by appellant was accepted and became binding upon the corporation upon the acceptance of the \$80,000 paid by Chartrand. The corporation thereupon became obligated to deliver 255 shares of corporate stock to Chartrand. Appellant Chartrand has met his full burden of proof by the trial court finding establishment of the agreement; the knowledge of the corporation, Finding of Fact No. 2 (T 68) the full performance by Chartrand by his payment of \$80,000 to and accepted by Appellee corporation, Finding of Fact No. 4 (T 68); the breach of agreement by Appellee in that only 240 shares were issued to Chartrand, Finding of Fact No. 6 (T 69).

THE CONTRACT IS ONE THAT MUST BE ENFORCED IN ITS ENTIRETY OR NOT AT ALL AND THE CORPORATION COULD NOT ALTER THE TERMS OF THE ORIGINAL AGREEMENT.

The rule is specifically stated in H. Horowitz v. Weehawken Trust and Title Co., 159 A. 384, 386 wherein it is stated:

"Whether we call the act by which the corporation becomes bound upon such contracts a ratification or an adoption thereof, it is well settled that, by voluntarily accepting the benefits accruing thereunder, after full knowledge, and having full liberty to decline the same, the corporation is regarded as adopting the contract cum onere, taking the burdens thereof, with the benefits. Seacoast R. Co. v. Wood, 65 N. J. Eq. 530, 56 A. 337; 14 C.J. 259, 260; 17 A.L.R. 477, annotation. This principle is but the adaptation of the wellrecognized rule of the law of agency to the law of corporations that, where a principal has an election either to repudiate or to ratify an unauthorized act of an agent on his behalf, he cannot, without the consent of the other party to the transaction, ratify in part or repudiate in part, but must either repudiate or ratify the whole transaction. He cannot ratify that part which is beneficial to himself and reject the remainder, but with the benefits he must take the burden. Thus a principal cannot ratify a contract made for him by an agent without also ratifying and becoming bound by the terms and conditions, although unauthorized, upon which it was made, or without ratifying the representations and warranties, and all other instrumentalities employed by the agent as an inducement to bring about the

contract. 2 C.J. 481, 482; Bodin v. Berg, 82 N.J. Law 662, at page 669, 82 A. 901, 40 L.R.A. (N.S.) 65, Ann. Cas. 1913D, 721.

So it must naturally follow that, while a corporation may adopt a contract made by another in its name before its incorporation, nevertheless in so doing it cannot adopt a part thereof which may be beneficial or desirable and discard that which is not, without the consent of the other party to the contract. Even in those jurisdictions which look upon the act of the corporation in accepting such a contract, not as a ratification thereof, because of the absence of agency, but rather as an adoption in the nature of a novation, or the making of a new contract by the corporation as of the date of the adoption, the ordinary rules of contract law must apply. 14 C.J. pp. 262, 263, §§ 294, 296. Hence, if the acts of the promoters of a corporation in making a contract for it before its organization are to be considered in the nature of a proposal to the future corporation for a contract, so that a binding engagement with the corporation will arise when it accepts the same after it has been fully organized, such acceptance must naturally be of the whole contract. as otherwise there would be no meeting of the minds essential to a binding legal engagement. 14 C.J. p. 263, § 296."

This proposition is also affirmed in *Alexander v*. Winters, 23 Nev. 475, 486, 49 P. 116, rehearing denied 24 Nev. 143, 50 P. 798.

"A person shall not be allowed at once to benefit by or repudiate an instrument, but, if he

chooses to take the benefit which it confers, he shall likewise take the obligations or bear the onus which it imposes . . ."

Other cases squarely in point are: Seymour v. Association, 144 N.Y. 333, 39 N.E. 365, 26 L.R.A. 859. In Re Super Trading Co., 22 F.2d 480.

CONCLUSION

In view of the foregoing the decision of the lower court denying equitable relief to the Appellant should be reversed and the trial court directed to deliver to Appellant Chartrand an additional fifteen (15) shares of stock of Barney's Club, Inc. and all of the incidents thereof.

Dated, Reno, Nevada, August 26, 1966.

Respectfully submitted,
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Attorneys for Appellant.

CERTIFICATE

We certify that, in connection with the preparation of this brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing brief is in full compliance therewith.

ERIC L. RICHARDS,

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No. 20,966

IN THE

United States Court of Appeals For the Ninth Circuit

RICHARD L. CHARTRAND,

Appellant,

VS.

Barney's Club, Inc., a Nevada corporation,

Appellee.

Appeal from the United States District Court for the District of Nevada

BRIEF OF APPELLEE

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Appellee.

Appeal from the United States District Court for the District of Nevada

BRIEF OF APPELLEE

JURISDICTION

Appellee, plaintiff below, brought suit against appellant, defendant below, in the Second Judicial District Court of the State of Nevada in and for the County of Washoe, praying for specific performance of an agreement to sell 240 shares of the capital stock of Barney's Club, Inc., a Nevada corporation, including an additional 15 shares which were in dispute, for the sum of Two Hundred Thousand Dollars (\$200,000.00). (Tr. 6.) Defendant below answered and counterclaimed for specific performance of a

pre-incorporation agreement (Tr. 50), to which plaintiff below replied, (Tr. 57.) Petition for Removal to the United States District Court for the District of Nevada was filed on November 1, 1963, on the grounds of diversity of citizenship and the jurisdictional amount being in excess of Ten Thousand Dollars (\$10,000.00), exclusive of interest and costs. (Tr. 3.) At the inception of the trial on November 23, 1965, plaintiff moved for a dismissal of its complaint with prejudice which was granted (Tr. 86), and the trial proceeded without a jury upon the issues raised by the counterclaim and the reply thereto. At the conclusion of the trial, the court held in favor of plaintiff below. Findings of Fact and Conclusions of Law (Tr. 67) were filed on December 29, 1965, and Judgment entered in favor of plaintiff on the same date. (Tr. 67.) Subsequently, Finding No. 7 was amended by the court and the amended finding was filed on February 8, 1966. (Tr. 87.) Timely Notice of Appeal was filed on March 9, 1966. (Tr. 90.) Statement of Points was filed on April 6, 1966. (Tr. 94.) The Transcript of Record was filed in this court on April 19, 1966.

This court has jurisdiction of this appeal pursuant to 28 U.S.C., § 1291, to review the judgment of the United States District Court for the District of Nevada.

QUESTION PRESENTED

Whether the court below correctly decided that the corporation had not adopted or ratified the pre-incor-

poration agreement and that therefore, the defendant below was not entitled to specific performance of 15 shares of the capital stock of Barney's Club, Inc.

SUMMARY OF ARGUMENT

Promoters of a corporation do not represent the corporation in any relation of agency or have any authority to enter into preliminary contracts binding upon the corporation. Therefore, a corporation is not liable upon any contracts which promoters attempted to make for it prior to its organization unless the obligation is assumed by the corporation's own act or acts after organization is completed. If a corporation, with knowledge of the pre-incorporation contract, accepts the benefits thereof, it will be required to perform the obligations incident thereto. However, ratification or adoption will not be presumed or inferred even where a corporation has received benefits under the pre-incorporation contract, unless actual knowledge of such contract is made to appear. The knowledge of the promoters cannot be imputed to the corporation. Even if we assume for the purpose of argument that knowledge of the pre-incorporation agreement can be imputed to the corporation, such imputation is negated by any action which the corporation takes which is in conflict with the pre-incorporation agreement, particularly where the defendant is a party to such action.

ARGUMENT

KNOWLEDGE OF PROMOTERS CANNOT BE IMPUTED TO THE CORPORATION.

The court below made a finding to the effect that where the corporation accepted benefits, knowledge of the pre-incorporation agreement would be imputed to it. (Tr. 89.) Appellee does not concede that that is the rule of law. The following cases have held that the knowledge of the promoters cannot be imputed to the corporation. Am.Jur.2d, §§ 119, 122 and 123. Commercial Lumber Co. v. Ukiah Lumber Mills, 94 Cal. App.2d 215, 210 P.2d 276; Gardiner v. Equitable Office Bldg., 273 F. 441 (C.A. 2d), 17 A.L.R. 431; Abbott v. Limited Mut. Compensation Ins. Co., 30 Cal. App.2d 157, 85 P.2d 961; Fred Macey Co. v. Macey, 143 Mich. 138, 106 N.W. 722; Chapman v. Sky L'-Onda Mut. Water Co., 69 Cal.App.2d 667, 159 P.2d 988; Tuttle v. Geo. A. Tuttle, 101 Me. 287, 64 A. 496; Murry v. Monter, 90 Utah 105, 60 P.2d 960; Bryan v. Northwest Beverages, Inc., 69 N.D. 274, 285 N.W. 689, 123 A.L.R. 717; Ramsey v. Brooke Co. Bldg. and Hotel Assoc., 102 W. Va. 119, 135 S.E. 249, 49 A.L.R. 668; Williams v. McNally, 39 Wyo. 130, 270 P. 411.

In the Commercial Lumber case, cited above, the court said:

"Plaintiff's contention that there was an implied ratification of the contract by the defendant corporation is likewise untenable. Lyons used part of the \$15,000 received from plaintiff to pay for the construction of the mill and to buy timber which was turned over to the corporation. Thereafter he caused stock to be issued therefor which

became a liability upon the books of the corporation. The fact that the permit from the Corporation. The fact that the permit from the Corporation Commissioner specified that the shares be sold for cash does not affect the situation as between plaintiff and the defendant corporation. Plaintiff loaned \$15,000 to Lyons upon his credit. At the time the transaction was entered into Lyons had not acquired the corporation and therefore was not its agent. The agreement was signed by him individually. Thereafter Lyons turned over certain assets to the corporation, including the lumber and the balance of the \$15,000 he had borrowed from plaintiff and he received therefor 125 shares of stock.

"Furthermore, even had the corporation received the benefits of the contract, ratification will not be presumed unless the corporation had actual knowledge of the specific contract out of which the benefits arose. Rideout v. National Homestead Ass'n, 14 Cal.App. 349, 351, 112 P. 192; Abbott v. Limited Mut. Compensation Ins. Co., 30 Cal.App.2d 157, 163, 85 P.2d 961. only person having actual knowledge of the transaction was Lyons. Bateman testified he had no knowledge of the contract at any time and when at his request Lyons submitted a financial statement of the corporation in September, 1946, it contained no reference to the contract or any notation of any indebtedness due to plaintiff from the defendant corporation. Lyons' knowledge of the transaction cannot be imputed to the corporation. The knowledge of a director who is directly interested in the contract is insufficient to charge the corporation and knowledge of a promoter who subsequently becomes a director cannot be imputed to the corporation. Abbott v. Limited Mut. Compensation Ins. Co., supra; Kiefhaber Lumber Co. v. Newport Lumber Co., 15 Cal.App. 37, 41, 113 P. 691."

In the Abbott case cited above, 30 Cal.App.2d 157, 163, 85 P.2d 961, the court held that to prove that a corporation adopted a promoter's contract engaging services of an attorney before the corporation was incorporated, evidence must show some affirmative act by the corporation from which adoption may be inferred, and receipt of benefits from the performance of the contract, without actual knowledge of its terms, or knowledge of a director directly interested in the contract is insufficient to charge the corporation. Knowledge of a promoter who subsequently becomes a director cannot be imputed to the corporation to charge the corporation with the adoption of a contract made by the promoter prior to the incorporation.

In a Federal case decided in the Second Circuit, Gardiner v. Equitable Office Building Corp., 273 Fed. 441, C.A. 2d, 17 A.L.R. 431, the court held that there is no liability on the part of a corporation for services rendered by its promoters in effecting the organization, even though they were rendered under expectation of payment, in the absence of express promise by it after its organization, unless such liability is imposed by charter or its general laws. It was argued in this case that the defendant corporation had the

benefit of the pre-incorporation agreement and is therefore impliedly bound by it. In reply to this argument, the court said:

"So far as this argument is concerned, it is enough to say that, to make the principle applicable, the corporation must have accepted the benefits with knowledge of the facts. All of the cases which recognize the doctrine so hold. And there is no evidence in this record that the corporation knew of the agreement made by DuPont in the Andrews letter. It is true it is said that two of the directors, DuPont and Dunham, had actual knowledge of the letter at the time of the taking over of the enterprise by the defendant. So far as the knowledge of DuPont is concerned, it is clear that it was not imputable to the corporation. A corporation is not charged with notice of facts known to a director in a transaction between him and the corporation, in which he is acting for himself and not for the corporation. Davis Improved Wrought Iron Wagon Wheel Co. v. Davis Wrought Iron Wagon Co. (C.C.) 22 Blatchf. 221, 20 Fed. 699; Commercial Bank v. Cunningham, 24 Pick. 270, 276, 35 Am.Dec. 322; Burt v. Batavia Paper Mfg. Co., 86 Ill. 66. The general rule that the knowledge of the agent is imputed to the principal rests upon the presumption that the agent will disclose what it is his principal's business to know and the agent's duty to impart. But the rule does not apply where the agent contracts with his principal, because in such a case there is no reason to presume that the agent will impart information which it is for

his interest to suppress. The knowledge of a promoter is not to be imputed to his corporation. Machen, Corp. § 348."

The above rule was again discussed in a California case cited above, *Chapman v. Sky L'Onda Mut. Water Co.*, 69 Cal.App.2d 667, 159 P.2d 988, in which the court had this to say:

"... The option contract, and the other contracts above mentioned, were not made in the name of the corporation, but were entered into by Crary and in his name for his own private purposes. It must be remembered that promoters are not the corporation, and that their contracts do not necessarily bind the corporation even though, after the subsequent organization of the corporation, they become the sole directors or officers. The rule, amply supported by authorities, is stated as follows in 6A Cal.Jur. 300, § 156:

'A corporation cannot be held liable for the acts of its promoters nor be obligated by their conduct and contracts towards or with others in the absence of * * * adoption of such conduct or contracts by the corporation after it comes into existence. The reason for this rule is that the promoters are not the corporation and their contracts cannot be its contracts, and this is so, even though the promoters become, upon the creation of the corporation, its sole stockholders, directors and officers * * *

'Ratification will not be presumed even where the corporation has received the benefits, unless actual knowledge of the specific contract out of which the benefits arose is made to appear.'" ASSUMING FOR PURPOSES OF ARGUMENT THAT KNOWLEDGE OF THE PROMOTERS OF THE PRE-INCORPORATION AGREEMENT IS IMPUTED TO THE CORPORATION, ANY ACTION TAKEN BY THE CORPORATION AND DEFENDANT WHICH IS IN CONFLICT WITH THE PRE-INCORPORATION AGREEMENT NEGATES SUCH IMPUTATION.

The court below, in its order on defendant's Motion for a New Trial, amended its Finding No. 7 to impute knowledge of the pre-incorporation agreement to the corporation. (Tr. 89.) However, the court stated:

"This amendment does not, however, change the Court's opinion and judgment. It is true, as argued by defendant, that although a pre-incorporation agreement is not ipso facto binding upon the subsequently organized corporation, if the corporation, without more, accepts the benefits of a pre-incorporation agreement with knowledge of its terms, it inferentially adopts the agreement and is bound by it, and no express adoption is necessary. But there is more to this case than that. Here the corporation adopted resolutions which were in conflict with the pre-incorporation agreement and these resolutions were ratified by Chartrand in his applications to the Nevada Gaming Commission. In other words, the evidence refutes the inference of adoption by the corporation of the pre-incorporation agreement which acceptance of benefits would otherwise justify. Of the many Court decisions cited by counsel in their helpful memoranda, this case is akin to Murry v. Monter, Utah 1936, 60 P.2d 960, where a corporation was held not bound by a pre-incorporation agreement in conflict with corporate resolutions and actions adopted and performed with the claimant's approval, consent and acquiescence, although other factors were also involved in that case." (Tr. 88, 89.)

In this connection reference is made to the following Findings of Fact and Conclusions of Law made by this court in support of its decision that action taken by the corporation and defendant subsequent to incorporation was in conflict with the pre-incorporation agreement and therefore, ratification or adoption of said agreement was never effected:

Finding No. 5. "On February 1, 1961, Chartrand made, executed and delivered to the Gaming Control Board of the State of Nevada an invested Capital Questionnaire signed and sworn to by him in which he claimed a 24% percentage interest in the operation of Barney's Club, Inc. Said document was filed concurrently with an application for a state gaming license made by B. E. O'Malia, as President of Barnev's Club. Inc., in which, among the individuals listed as being interested in the operation, was C & O Investment Co., Inc., with a 51% investment in Barney's Club, Inc., parceled among Richard L. Chartrand, 45%; Bernard E. O'Malia, 45%; William F. O'Malia, 5%; and Frances L. O'Malia, 5%, which, derivatively, asserted a 24% interest to Richard L. Chartrand in Barney's Club, Inc. At that time, Chartrand and O'Malia contemplated the incorporation of C & O Investment Co., Inc. to hold their stock interests in Barney's Club, Inc., and Articles of Incorporation for C & O Investment Co., Inc., were filed on March 14, 1961. Said corporation was never fully organized or activated. Thereafter, and on April 11, 1961, Bernard E. O'Malia and Richard L. Chartrand

jointly directed a letter to the Gaming Control Board of Nevada, as follows:

'Permission is hereby requested to delete that portion of the application filed February 13, 1961, which reads C & O Investment Co., Inc.

'This corporation will not be formed as contemplated and the applicants will become stockholders in Barney's Club, Inc., dba Barney's Club with beneficial ownership in the latter corporation in the same percentage as they would have held had the C & O Investment Company been incorporated.'" (Tr. 68, 69.)

Finding No. 6. "In February and March, 1961, the Board of Directors of Barney's Club, Inc. was comprised of Barney E. O'Malia, Frances O'Malia, his wife, and William F. O'Malia, his son. On February 17, 1961, the Board of Directors adopted a resolution approving the issuance of 510 shares of the capital stock of the corporation to C & O Investment Co., Inc. On March 20, 1961, the Board of Directors adopted a resolution rescinding the resolution adopted February 17, 1961, and approving the issuance of capital stock of the corporation as follows: Barney E. O'Malia, 240 shares; Richard Chartrand, 240 shares, Frances O'Malia, 15 shares; William F. O'Malia, 15 shares.

"The foregoing are the only corporate minutes relevant to the stock entitlement of Chartrand before a dispute arose with respect thereto. There are no organization minutes recording the corporation's obligation at the time the real property at Stateline, Nevada, acquired for the use of the corporation, was deeded to the corporation." (Tr. 69, 70.)

Conclusion No. 2. "An adoption of a pre-incorporation agreement may be implied if the evidence shows that the corporation accepted the benefit of the agreement, with knowledge thereof and with the inferred intent that it be bound thereby." (Tr. 71.)

Conclusion No. 3. "There is no credible evidence that Barney's Club, Inc., a corporation, ever assumed or intended to be bound by the pre-incorporation agreement to the effect that O'Malia and Chartrand each receive 25½% of the authorized capital stock of the corporation." (Tr. 71.)

Conclusion No. 4. "The minutes of meetings of the Board of Directors of Barney's Club, Inc. would not be of much evidentiary weight inasmuch as the Board was then composed of O'Malia and members of his immediate family, if the resolutions of the Board then adopted were not corroborated by actions taken in implementation thereof in which Chartrand participated with respect to the applications to the Nevada Gaming Control Board for a gaming license. After the adoption of such resolutions, the applications to the Gaming Control Board and the issuance of stock conformably with the resolution adopted on March 20, 1961, Chartrand paid to the corporation the final installment (\$30,000) of his \$80,000 pre-incorporation subscription agreement." (Tr. 71.)

Conclusion No. 5. "The foregoing, in summary, is the most persuasive evidence adduced relevant to the responsibility of the corporation for the issuance of shares of its capital stock to O'Malia and Chartrand, respectively." (Tr. 71.)

Conclusion No. 6. "The burden of proof is upon Chartrand to establish that Barney's Club, Inc., a corporation, adopted the pre-incorporation agreement between O'Malia and Chartrand with respect to Chartrand's entitlement to 255 shares of the corporate stock." (Tr. 71.)

Conclusion No. 7. "The evidence hereinabove related creates a substantial uncertainty regarding whether the corporation received monies from Chartrand with knowledge of the pre-incorporation agreement, or whether the corporation adopted such agreement. Chartrand has not sustained the burden of proof in that respect." (Tr. 71, 72.)

Conclusion No. 8. "Richard L. Chartrand is not entitled to the issuance to him of an additional 15 shares of the capital stock of Barney's Club, Inc. by reason of the transactions referred to in the evidence and summarized in the foregoing Findings of Fact." (Tr. 72.)

Thus, it will be noted that subsequent to incorporation, the following events took place which are not compatible with the defendant's position that the corporation is bound by the terms of the pre-incorporation agreement. On February 1, 1961, defendant made, executed and delivered to the Gaming Control Board of the State of Nevada an Invested Capital Questionnaire, under oath, in which defendant claimed a 24% interest in the operation of the corporation (Tr. 69), and not 25½% which defendant now claims. On the same date an application was filed by the president of the corporation with the Gaming Control Board

of the State of Nevada in which, among the individuals listed as having an interest in the operation of the corporation, was C & O Investment Co., Inc., with a 51% investment in the corporation parcelled out in the following manner: Defendant, 45%; Bernard E. O'Malia, 45%; William F. O'Malia, 5%; and Frances L. O'Malia, 5%, which derivatively asserted a 24% interest in Barney's Club, Inc., to defendant. (Tr. 69.) Defendant and Bernard E. O'Malia had contemplated the formation of the C & O Investment Co., Inc., to hold their interests in the corporation but this was never effected. (Tr. 69.) Thereafter, on April 11, 1961, defendant and Bernard E. O'Malia jointly directed a letter to the Gaming Control Board requesting deletion of any reference to C & O Investment Co., Inc., from the application filed theretofore, and further informed the Gaming Control Board that the beneficial ownership in the corporation will be in the same percentage as they would have held had the C & O Investment Co., Inc., been incorporated. (Tr. 68, 69.) On February 17, 1961, the Board of Directors of the corporation adopted a resolution approving the issuance of 510 shares of the capital stock of the corporation to C & O Investment Co., Inc., and on March 20, 1961, this resolution was rescinded and a new resolution was adopted approving the issuance of capital stock of the corporation as follows: Bernard E. O'Malia, 240 shares; Richard Chartrand, 240 shares; William F. O'Malia, 15 shares; and Frances L. O'Malia, 15 shares. (Tr. 69, 70.) It was after the adoption of the above resolutions, the issuance of the stock, and applications to the Gaming Control Board that defendant paid to the corporation his final installment of \$30,000 under the pre-incorporation agreement. (Tr. 71.)

A case in which action taken by the corporation inconsistent with the pre-incorporation agreement was discussed is *Murry v. Monter*, 90 Utah 105, 60 P.2d 960 (1936). In that case, articles of incorporation were signed by the incorporators, including plaintiff, which provided for a different distribution of the corporate stock than that provided for in the pre-incorporation agreement. The court stated the general rule that a corporation accepting the benefits of the contract of its incorporators, with knowledge of such contract, must accept the burden. The court had this to say:

"The general rule of law is that promoters who undertake to organize a corporation cannot bind the corporation by their contracts and agreements made before the corporation is organized. Tanner v. Sinaloa Land & Fruit Co., 43 Utah, 14, 134 P. 586, Ann.Cas. 1916C, 100; Wall v. Niagara Mining & S. Co., 20 Utah, 474, 59 P. 399, 401; 1 Thompson on Corps. (3d Ed.) § 106; 4 Cook on Corps. (8th Ed.) § 707. But that the corporation after incorporation may accept and adopt such a contract which thereupon becomes its own contract, which may be enforced by or against it. Wall v. Niagara Mining & S. Co., supra. The rule is succinctly stated in 4 Cook on Corps. (8th Ed.) § 707, p. 2894: 'A corporation accepting the benefits of the contract of its incorporators must accept the burden, and a promoter's contract which has been ratified or adopted by the corporation, or the benefits of which have been accepted by the corporation with knowledge of such contract, may be enforced against it.'

"The corporate liability where the corporation accepts and retains the benefits of a promoter's contract is on the theory of implied contract or of estoppel. The rule is quite uniform that if a corporation with knowledge of a contract accepts the benefits thereof it will be required to perform the obligations. Gardiner v. Equitable Office Bldg. Corp. (C.C.A.) 273 F. 441, 17 A.L.R. 431, and note 49 A.L.R. 673.

"The rule of law on which defendants rely is that stated in 4 Page on the Law of Contracts, § 2492: 'A subsequent contract which does not by express terms abrogate an earlier contract, will, nevertheless, operate as a discharge thereof if it is inconsistent with such earlier contract. If the later contract does not expressly abrogate the earlier in toto, but is inconsistent therewith, the scope of the later contract determines whether any part of the earlier contract is in force. If the later contract between the parties covers the same subject-matter and has the same scope as the earlier contract, but is in whole or in part inconsistent therewith, the later contract abrogates the earlier contract in toto and is the only contract upon the subject between the parties.' See. also, Housekeeper Pub. Co. v. Swift (C.C.A.) 97 F. 290; Sherman v. Sweeny, 29 Wash. 321, 69 P. 1117.

"Defendants' reliance on this rule rather presupposes that the corporation would be liable on the contract with the promoter but for the second contract which entirely replaced the first, the scope of the two being identical and the later in-

consistent with the first contract. If plaintiff can hold the mining company, it must be on the theory that the corporation adopted the contract between Murry and Monter and made it its own or with knowledge of such contract accepted and kept the benefits. There is no evidence that the corporation by either formal or informal action adopted the Murry-Monter contract. There is no acknowledgement of the contract in the articles of incorporation or by action of the board of directors. There is no evidence tending to show that any of the incorporators other than Murry and Monter had any knowledge of the existence of the contract at the time of the incorporation, and neither of these men so much as suggested the existence of such contract until some months afterwards when Murry demanded 120,000 shares of stock from Monter. The secret knowledge of these men obtained at a time when neither had authority to bind the future corporation cannot be said to be knowledge of the corporation. Gardiner v. Equitable Office Bldg. Corp., supra. The evidence does not disclose that the corporation with knowledge of the contract accepted its benefits. The corporation was entitled to rely on the contract made with Murry in the articles of incorporation wherein he agreed to deed his interest in the mining claims for the amount of stock subscribed by him."

DEFENDANT IS BOUND BY THE FINDINGS OF FACT MADE BY THE TRIAL COURT.

The defendant is bound by the Findings of Fact made by the court below and all facts which are included in the Conclusions of Law and which are not included in the Findings of Fact. Oregon Iron & Steel Co. v. Kelso State Bank, 129 Wash. 109, 204 P. 569. In a Federal case, Turner Glass Corp. v. Hartford-Empire Co., C.A. 7th, 1949, 173 Fed.2d 49, cert. den., 70 S. Ct. 57, 338 U.S. 830, 94 L.Ed. 505, it was held that the Court of Appeals was required to accept the trial court's findings as correct where plaintiff appealed from judgment dismissing its complaint after a trial upon the merits, and pursuant to plantiff's request that only certain questions of law be considered on the appeal, all of the oral testimony and all of defendants' exhibits were omitted from the record.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the court below should be affirmed.

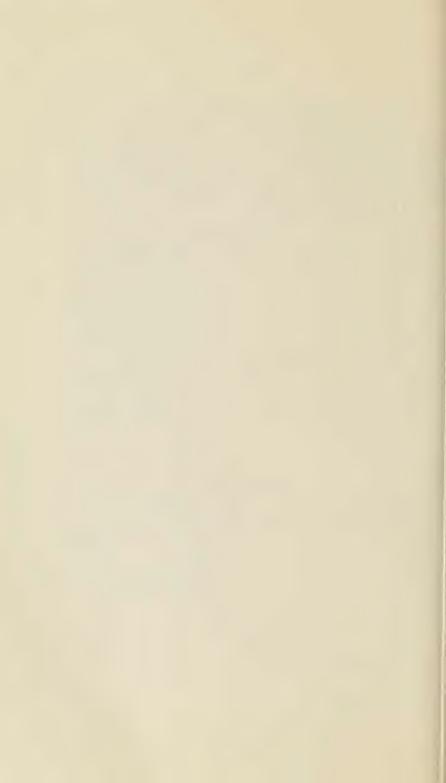
Dated, Reno, Nevada, September 23, 1966.

Respectfully submitted,
ELI GRUBIC,
Attorney for Appellee.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance therewith.

ELI GRUBIC,
Attorney for Appellee.



No. 20,966

IN THE

United States Court of Appeals For the Ninth Circuit

RICHARD L. CHARTRAND,

Appellant,

VS.

BARNEY'S CLUB, INC., a Nevada corporation,

Appellee.

Appeal from the United States District Court for the District of Nevada

APPELLANT'S REPLY BRIEF

Eric L. Richards, Jack I. McAuliffe, Of the Firm of

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STREETER, SALA, RICHARDS & McAULIFFE,

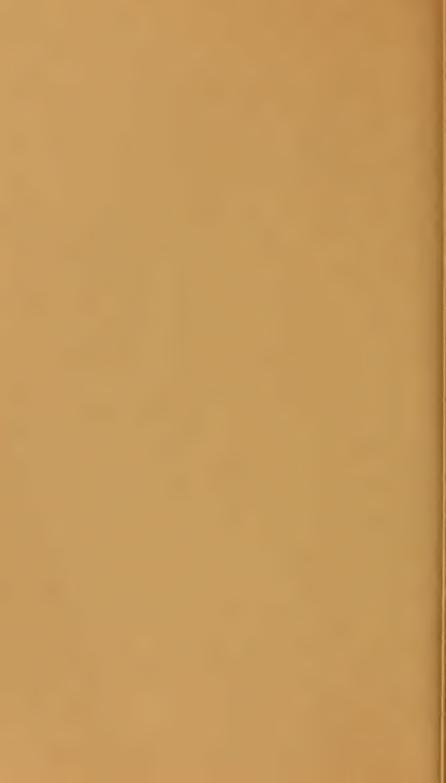
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WM. B. LUCK CLERY



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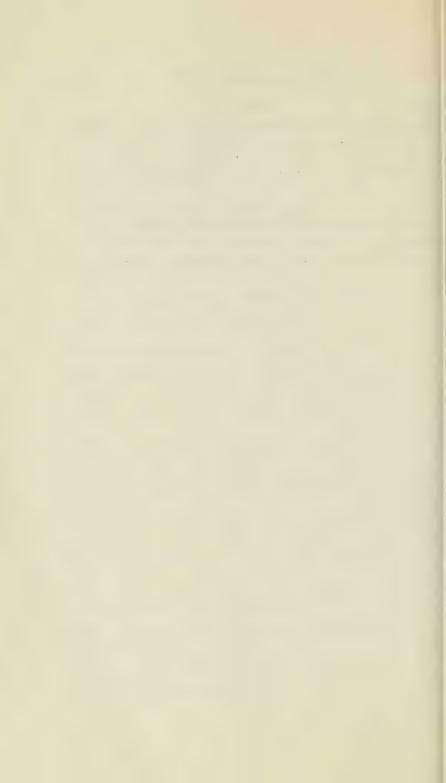
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IN THE

United States Court of Appeals For the Ninth Circuit

RICHARD L. CHARTRAND,

Appellant,

VS.

Barney's Club, Inc., a Nevada corporation,

Appellee.

Appeal from the United States District Court for the District of Nevada

APPELLANT'S REPLY BRIEF

SUMMARY OF REPLY ARGUMENT

Appellant acknowledges that he is bound by the lower court's findings of facts and does not dispute such findings. Apparently Appellee misconceives the nature of these findings for the trial court's finding was not to the effect that since the corporation received the benefits of the pre-incorporation contract knowledge of the contract would thereby be imputed to it. The lower court's finding was that the corporation had knowledge of the terms of the agreement prior to its acceptance of the benefit because O'Malia was the President and guiding spirit of the corporation and he and his wife and son comprised the three man board of directors.

The Appellant submits that upon the facts found by the court the corporation became bound by the Chartrand-O'Malia agreement and that since no affirmative defenses, if any existed, were plead or proved, they were waived.

Nowhere is it contended that the corporation did not receive the entire benefit of the contract and the agreement after acceptance of the benefits cannot be altered by the unilateral action of the corporation.

The appellant has carried his burden of proof by proving the terms of the pre-incorporation contract and full compliance therewith and is entitled to fifteen additional shares of capital stock of Barney's Club, Inc.

IS APPELLEE BOUND BY DISTRICT COURT'S FINDINGS WHERE HE HAS MADE NO CROSS-APPEAL?

Appellee is apparently attempting to dispute the findings of the District Court that Barney's Club, Inc. had knowledge of the pre-incorporation agreement, which is the subject of this action. Since Appellee has not cross-appealed, this finding cannot now be reviewed on appeal. Abel v. Brayton Flying Service (5th Cir.) 248 F.2d 713 (1957); Teas v. Kimball (5th Cir.) 275 F.2d 817 (1958). Where a timely notice of cross-appeal had not been filed by appellee, the Court of Appeals for the Second Circuit refused to review the findings of the lower court even though the court was inclined to conclude that the findings lacked support in the evidence. Schildhaus v. Moe (2nd Cir.) 319 F.2d 587 (1963).

Even assuming that the findings below are reviewable on appeal, appellee misapprehends the nature of the amended finding of the Court below. The trial court's finding was not to the effect that since the corporation received the benefits of the pre-incorporation contract, knowledge of the contract would thereby be imputed to it. The lower court made a finding that the corporation knew of the terms of the pre-incorporation agreement between Chartrand and O'Malia because "O'Malia was the President and guiding spirit of the corporation and he, his wife and his son comprised the three man board of directors." (T. 88).

Knowledge of a promoter can be imputed to the corporation where the promoter becomes a director, officer and major stockholder of the corporation he has formed. Wallace v. Eclipse Pocahontas Coal Co., 83 W. Va. 321, 98 S.E. 293; Wall v. Niagara Mining & Smelting Co. of Idaho, 20 Utah 474, 59 Pac. 399; Seymour v. Association, 144 N.Y. 333, 39 N.E. 365, 26 L.R.A. 859; New England Oil Refining Co. v. Wiltsee, 3 F.2d 424; In Re Super Trading Co., 22 F.2d 480; Buckman v. Bankers Mortgage Company, Mo. App. 263 S.W. 1046; Pleasants, et al. v. Blackberry, Kentucky & West Virginia Coal & Coke Co., 201 Ky. 144. 255 S.W. 1043; In Re Quality Shoe Shoppe, Inc., 212 Fed. 321; Oakes v. Cattaraugus Water Co., 143 N.Y. 407, 38 N.E. 461; Lowther v. Blair Distilling Co., 266 Ky. 428, 99 S.W. 2d 204.

Further, the entire \$80,000 specified in the pre-incorporation agreement was paid to the corporation by Chartrand after it was formed. Barney O'Malia as President and Chairman of the Board of Directors, was the corporation's agent when the money was accepted. He was the "guiding spirit" of the corporation and its President and along with his immediate family, comprised the entire Board of Directors. The corporation could have refused the \$80,000 and thus declined to accept the benefits of the pre-incorporation agreement had it chosen to do so. Thus, not only O'Malia's knowledge as a promoter and director of Barney's Club, Inc. must be imputed to the corporation, but also his knowledge as president and chairman of the board.

It is well settled in Nevada that knowledge acquired by an agent of the corporation is knowledge of the corporation. The court stated in Strohecker v. Mutual Building & Loan Association of Las Vegas, Nevada, 55 Nev. 350, 355, 34 P.2d 1076 as follows:

"A corporation can acquire knowledge or receive notice only though its officers and agents, and hence the rule holding a principal, in case of a natural person, bound by notice to his agent is particularly applicable to corporations, the general rule being that the corporation is affected with constructive knowledge, regardless of its actual knowledge, of all the material facts of which its officer or agent receives notice or acquires knowledge while acting in the course of his employment and within the scope of his authority, and the corporation is charged with such knowledge even though the officer or agent does not in fact communicate his knowledge to the corporation."

Further evidence that the directors and officers had notice of the pre-incorporation agreement is found in one of the stipulations in the pretrial order. Paragraph 22 (T. 64) "The corporation executed Stock Certificate No. 32 in the amount of 255 shares to Richard L. Chartrand on October 3, 1960, which certificate was never delivered to Mr. Chartrand."

In Bryan v. Northwest Beverages, Inc., 69 N.D. 274, 285 N.W. 689, 123 A.L.R. 717, cited in appellee's brief, one of the factors which the court stressed in deciding that the corporation had knowledge of the pre-incorporation agreement and thereby became bound by it was the fact that the corporation issued the shares of stock according to the agreement, retained them and later cancelled them.

The fact that the corporation has partially performed on the contract in question by issuing Chartrand 240 shares of stock in Barney's Club is further evidence that the corporation had knowledge of the agreement.

Another indication that the corporation had actual knowledge of the agreement is that O'Malia and his immediate family received in excess of 255 shares of the capital stock of Barney's Club, Inc. (T. 69, 70).

It is clear that the corporation had not only constructive knowledge of the Chartrand-O'Malia agreement through Barney O'Malia as a promoter, but also had actual knowledge through its directors and officers after the incorporation of Barney's Club, Inc.

The appellee does not deny that the corporation has received the benefit of the pre-incorporation con-

tract. See plaintiff's answer, Paragraph IV (T. 57, 58). The trial court also found in its findings of fact that the agreement was that Chartrand and O'Malia cach were to contribute \$80,000, and that Chartrand had in fact paid the \$80,000 to the corporation (T. 68). There is no question whatsoever that Barney's Club, Inc. received the entire benefit of the contract and nowhere is it contended that this agreement was not for the benefit of the corporation.

Therefore, the corporation should be bound by the agreement under the general rule that if a corporation with knowledge of a pre-incorporation contract accepts the benefits thereof, it will be required to perform the obligations. Murry v. Monter, 90 Utah 105, 60 P.2d 960; Gardiner v. Equitable Office Building Corporation, 273 Fed. 441 (C.A. 2d) 17 A.L.R. 431; Commercial Lumber Co. v. Ukiah Lumber Mills, 94 C.A. 2d 215, 210 P.2d 276; Bryan v. Northwest Beverages, Inc., 69 N.D. 274, 285 N.W. 689, 123 A.L.R. 717; Ramsey v. Brooke County Bldg. & Loan Assn., 102 W. Va. 119, 135 S.E. 249, 49 A.L.R. 668; 4 Cook, Corporations (8th Ed.) Sec. 707, p. 2894.

CHARTRAND HAS SUSTAINED THE BURDEN OF PROOF THAT BARNEY'S CLUB, INC. HAS ADOPTED THE PRE-INCORPO-RATION CONTRACT AS ITS OWN: THE BURDEN OF PROOF IS ON APPELLEE THAT THE CONTRACT WAS DISCHARGED.

It is well known that the party seeking specific performance of a contract must prove the material facts with regard to his right to specific performance and the opposing party must plead and prove the facts relied upon as a defense. It must be proved that there is a contract binding upon the parties and that the party seeking specific performance has fully performed or has offered to perform his part of the contract. *Bowman v. Reyburn*, 115 Colo. 82, 170 P.2d 271.

In a suit against a corporation on a promoter's contract, the burden is on the plaintiff to prove the necessary elements of his claim, among them, that the corporation received and accepted the benefits of the contract. Glass v. Newport Clothing, 110 Vt. 368, 8 A.2d 651. Chartrand has proved that Barney's Club, Inc. has received the benefits of the contract, namely the \$80,000 which was to be paid in return for 255 shares of stock.

The corporation's knowledge of the contract has also been proved (T. 89). Therefore, appellant's burden of proof has been sustained that the corporation adopted the contract. Further, since Chartrand has fully performed his part of the bargain, he is entitled to specific performance of the 15 shares of capital stock of Barney's Club, Inc. It is not necessary for appellant to further prove that the contract has not been discharged in some manner, and the burden of any such defense shifted to the appellee. It was incumbent on the corporation to plead and prove any affirmative defenses it may have had.

The Restatement of the Law of Contracts, Vol. II, § 385, pp. 725, 726 sets out 21 methods by which a contractual duty may be discharged. Barney's Club, Inc. in its answer to Chartrand's counter-claim inter-

posed a general denial and no affirmative defense (other than the alleged settlement agreement) to the pre-incorporation contract was plead.

Rule 8 (c) of the Federal Rules of Civil Procedure requires that in answer to a pleading, estoppel, waiver or other matter constituting an avoidance or affirmative defense must be set forth affirmatively. Rule 12 (h) provides that if affirmative defenses are not plead nor made the subject of motion under 12 (b), they are waived. Carter v. Powell (5th Cir.) 104 F.2d 428; Systems Incorporated v. Bridge Electronics Company (3rd Cir.) 335 F.2d 465.

Barney's Club did not plead estoppel, waiver, novation or any other affirmative defense. It has not been set forth that there was an abandonment of the original contract or that a novation was effected thereby or that there was a rescission of the pre-incorporation agreement upon the signing of the application to the Nevada Gaming Control Board. Yet, the decision below seems to be bottomed on one or all of these points in spite of the fact that no affirmative defense was plead at all.

Assuming arguendo, that any one or all of the above defenses were properly plead, the question still remains whether the application to the Nevada Gaming Control Board can in some manner supersede the Chartrand-O'Malia agreement, thereby cutting off Chartrand's right to 15 more shares of stock. The Murry v. Monter case cited by the court below is not authority for this proposition. It is distinguishable on its facts.

Murry and Monter were both promoters of Tintic Mining Co. Murry agreed to transfer certain mining claims to Monter on the day of incorporation of Tintic in return for 120,000 shares of stock. At the time, it was contemplated that the corporation would issue 2,000,000 shares of stock and each of the subscribers would receive a certain number of shares. At the time of incorporation, the decision was made to cut the authorized capital stock in half, or to issue only 1,000,000 shares. Thereafter, each of the incorporators received the same percentage of stock for which he had subscribed, although each received half the number of shares as originally contemplated. articles of incorporation were were signed by Monter and Murry and three others, as incorporators, provided for 1,000,000 shares of stock, 300,000 of which would be issued to the subscribers, of which Murry subscribed 60,000 shares. The articles recited that the subscriptions were paid in full by the transfer of various mining claims. At the same time, Murry transferred all the property, which was the subject of the contract, to the corporation by deed. Nothing was said at this time or at any later meeting of the Board of Directors, of which Murry was a member, that he had a right to more than 60,000 shares. Several months later, Murry demanded the remaining 60,000 shares from Monter. The holding of the court in that case was distinguishable in this fashion.

First, it was held that this was a secret agreement between Murry and Monter. None of the other three incorporators had any knowledge of the contract and further, that the corporation had no knowledge of it. Therefore, the corporation could not be said to have adopted the agreement by accepting the benefits of the contract with knowledge of its terms.

Secondly, although it was specifically pleaded that Murry's signing the articles of incorporation, wherein he agreed to deed his interest in the claims for the 60,000 shares, which was inconsistent with the prior contract, resulted in a rescission, a waiver and an abandonment of the original contract, the court rejected that argument. It stated that such a defense pre-supposes that the corporation would be liable on the promoter's contract, but since the corporation had no knowledge of the contract, it had not adopted it. Therefore, the only contract binding upon the corporation was the one evidenced by the articles of incorporation, wherein Murry agreed to convey his interest in the mining claims for 60,000 shares of stock subscribed.

The third and probably most important argument was that Murry received the exact proportion of ownership in Tintic corporation as he had bargained for.

In the case at bar, the resolution to issue Chartrand 240 shares was made by a Board of Directors comprised of O'Malia, his wife, and his son. O'Malia was the president and guiding spirit of Barney's Club, Inc. (T. 88). The mere signing of the application to the Gaming Control Board affirming that 240 shares of stock had been issued to him does not in any sense "ratify" a decision by the Board of Directors (domi-

nated by O'Malia) not to issue an additional 15 shares. Chartrand has repeatedly demanded the additional 15 shares of capital stock of Barney's Club, Inc. in conformity with the pre-incorporation contract (T. 70).

Appellee cannot now attempt an affirmative defense by inference or implication which he has not plead or proved.

SHOULD APPELLEE BE ALLOWED TO UNILATERALLY CHANGE OR MODIFY THE PRE-INCORPORATION AGREEMENT AFTER APPELLANT HAS FULLY PERFORMED HIS PART OF THE CONTRACT?

No abrogation, change, modification, or substitution in a primary contract can be effected by the sole action of one of the parties to it. The consent of both is required to cancel, alter, or supplant a contract fairly made. The same meeting of the minds is needed that was necessary to make the contract in the first place. Consideration is also required. H. Horowitz v. Weehawken Trust & Title Co., 10 N.J. Mis. R. 417, 159 A. 384; Wheeler v. New Brunswick & C.R. Co., 115 U.S. 29, 5 S. Ct. 1061; Holland v. Crummer Corp., 78 Nev. 1, 368 P.2d 63.

"A person shall not be allowed at once to benefit by and repudiate an instrument, but, if he choose to take the benefit which it confers, he shall likewise take the obligations or bear the onus which it imposes . . ." Alexander v. Winters, 23 Nev. 475, 486, 49 Pac. 116.

"One Party cannot, while he retains the benefit of a substantial performance, totally defeat an action for the price which he agreed to pay, or for specific performance on his part, on the ground that the plaintiff has not completed the contract. He cannot at the same time affirm the contract by retaining its benefits and rescind it by repudiating its burdens. The reason for this principle is that the retention of the benefits of a substantial performance after a default is utterly inconsistent with the position that the default has released the party who has received these benefits, so that he is not bound to perform his part of the contract." Turley v. Thomas, 31 Nev. 181, 193, 101 Pac. 568, citing German Sav. Inst. v. De La Vergne R. M. Co., 70 Fed. 146, 17 C.C.A. 34.

Barney's Club is bound to perform its part of the contract after having received the entire consideration from appellant.

APPELLANT ACKNOWLEDGES THAT HE IS BOUND BY THE FINDINGS OF FACT MADE BY THE TRIAL COURT.

The appellant acknowledges that he, as well as appellee, is bound by the Findings of Fact and all facts which are included in the Conclusions of Law which are not included in the Findings of Fact made by the court below. It is from these findings that the appellant contends that the corporation adopted the agreement and is bound thereby to full performance.

CONCLUSION

In view of the foregoing the decision of the lower court denying equitable relief to the appellant should be reversed and the trial court directed to deliver to appellant Chartrand an additional fifteen (15) shares of stock of Barney's Club, Inc. and all of the incidents thereof.

Dated, Reno, Nevada, October 17, 1966.

Respectfully submitted,
ERIC L. RICHARDS,
JACK I. MCAULIFFE,
Of the Firm of
STREETER, SALA, RICHARDS & MCAULIFFE,
Attorneys for Appellant.

CERTIFICATE OF COUNSEL

We certify that, in connection with the preparation of this brief, we have examined Rules 18 and 19 of The United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing brief is in full compliance therewith.

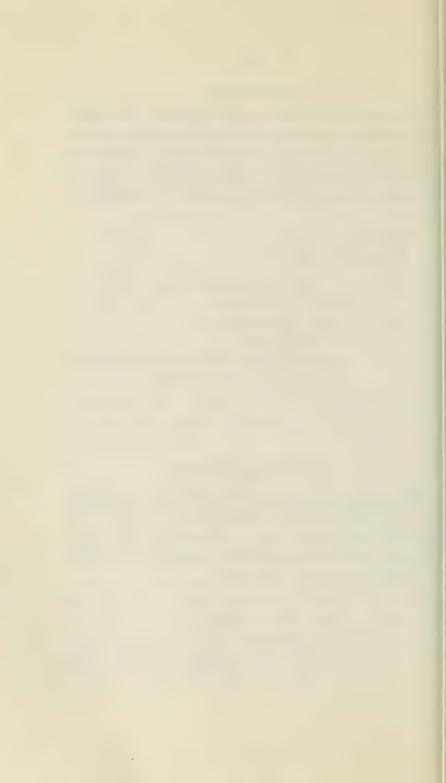
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Attorneys for Appellant.



No. 20,981

In the

United States Court of Appeals

for the Ninth Circuit

John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

VS.

Archie Snider, individually and doing business as Snider Construction Co.,

Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California, Southern Division

Opening Brief of Appellant Archie Snider, Individually and Doing Business as Snider Construction Co.

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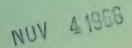
Attorneys for Appellant Archie Snider, individually and doing business as Snider Construction Co.

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In the

United States Court of Appeals

for the Ninth Circuit

John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

VS.

Archie Snider, individually and doing business as Snider Construction Co.,

Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California, Southern Division

Opening Brief of Appellant Archie Snider, Individually and Doing Business as Snider Construction Co.

I.

PRELIMINARY STATEMENTS

A. Opinion Below.

The District Court filed a Memorandum of Opinion that appears at pages 42-47 of the Transcript of Record.

B. Jurisdiction.

This action was brought by a trustee in bankruptcy to set aside an alleged voidable preference in favor of the defendant. Jurisdiction was confirmed by \$\$ 60 and 67 of the Bankruptcy Act. Defendant's appeal from the adverse judgment was timely prosecuted pursuant to Rule 73, Federal Rules of Civil Procedure.

C. Statement of the Case.

Plaintiff-appellee is the trustee in bankruptcy of Mahl Associates, Inc., a corporate bankrupt. Defendant-appellant is an individual. Plaintiff seeks \$15,668.68 plus interest from March 20, 1962 on the ground that defendant received a voidable preference from the bankrupt.

Defendant contended that the transfer did not occur while Mahl Associates was insolvent, but even if it did, he neither knew nor did he have reasonable cause to believe at that time that Mahl Associates was in fact insolvent.

The trial court sitting without a jury found that all of the elements of a voidable preference existed and awarded judgment for plaintiff.

The questions on appeal presented by defendant are summarized in the following specifications of error.

D. Specifications of Error.

- 1. The evidence does not support the following material findings of fact and conclusions of law:
- (a) That on or about December 1, 1961, when the payment of the sums of \$10,176.66 and \$5,492.02 were made to defendant Archie Snider, and at all times thereafter, the bankrupt was insolvent within the meaning of \$1(19) of the Bankruptey Act, as amended (T.R. 49).

- (b) That on or about December 1, 1961, when the payment of the sums of \$10,176.66 and \$5,492.02 were made to defendant Archie Snider, and at all times thereafter, defendant Archie Snider had reasonable cause to believe that the bankrupt was insolvent (T.R. 49).
- (e) That the payment to defendant Archie Snider of the sums of \$10,176.66 and \$5,492.02, as set forth in findings of fact nos. 6 and 7, constituted a voidable preference under \$60(a) and (b) of the Bankruptcy Act, as amended, and that plaintiff is entitled to judgment against Archie Snider, individually and doing business as Snider Construction Company, in the sum of \$15,668.68, plus interest at the legal rate from March 20, 1962, and for plaintiff's costs of suit (T.R. 50).
- 2. The trial court committed reversible error in refusing admission of testimony and exhibits by the following witnesses of defendant:
 - (a) James H. Holderby:

Mr. Holderby, an assistant manager of the Mills Branch of the Bank of California in Burlingame, was testifying as to three credit inquiries to the bank relating to the bankrupt and the bank's replies to those inquiries. The three inquiries and three replies were offered into evidence as a group exhibit and were rejected upon plaintiff's objection "as incompetent, irrelevant, and immaterial, and they are hear-say and full of opinions and conclusion, and no indication of any tie in with the bankrupt corporation of plaintiff." (R.T. 103:14-18; this testimony and argument commences at R.T. 100:23 and concludes at R.T. 105:22.)

(b) Ernest Vedovie:

It was stipulated that Mr. Vedovie would testify as follows:

"He represented as broker the purchaser of the real property occupied by Mahl Associates. The purchase being consummated about December 1, 1961, and what he would testify, that the purchase price was based upon the \$800 per month rent that Mahl was paying, and that he made an inquiry through his bank as to Mahl Associates. He got a Dun and Bradstreet report that indicated that Mahl Associates was a reasonably sound tenant based upon that report. That is all." (R.T. 121:14-22.)

The Court sustained the objection to that testimony "as not being impeachment. It is hearsay, and incompetent, irrelevant, and immaterial." (R.T. 121:23-24; this testimony and argument commences at R.T. 121:12 and concludes at R.T. 122:23.)

II.

STATEMENT OF FACTS

Mahl Associates, Inc., the bankrupt, was a California corporation. Its principal business was the purchase and installation of laundry and dry-cleaning equipment at commercial locations for the use of the general public (R.T. 6). Defendant, Archie Snider, was a small contractor who did business as Snider Construction Co. (R.T. 106, 107).

In April of 1961 Mr. Snider leased certain premises he owned to Mahl Associates (R.T. 7, 108). Shortly after taking possession, Kenneth Mahl, president of Mahl Associates, requested Mr. Snider to make additional enlargements and improvements so as to accommodate Mahl's expanding business (R.T. 7, 108). This work was done and Mr. Snider billed Mahl Associates a total amount of \$5,492.02 in July and September of 1961 (R.T. 7, 109).

In August of 1961, Mahl went to Mr. Snider and said that the Corporation was temporarily short of working capital and needed a loan to meet the current payroll; that it had requested loans from various banks; and, that such loans would soon be forthcoming (R.T. 9, 31, 110). He also said that work in progress and potential accounts receivable were substantial and would be collectible in the not too distant future (R.T. 111-112, 113).

As a result of these representations Mr. Snider advanced \$10,000 to the corporation on August 15, 1961, and took a note for that sum payable on September 15, one month later (R.T. 9-10, 111). The note was not paid on the due date (R.T. 10-11, 111). After the note matured, Mr. Snider inquired of Mahl as to his intentions and was informed that the requests for loans had been turned down and that the corporation could not at that time retire the note or pay the bills for the construction work, but that there was substantial work in progress which would pay off in a short time and that the debts could then be paid (R.T. 11, 111, 113).

As landlord Mr. Snider, from the outset of Mahl's tenancy, customarily received the rent payments late, although rent was paid through October of 1961 (R.T. 112-113).

During September, October, and November of 1961 discussions concerning the debt owed Mr. Snider took place (R.T. 11-14, 33, 113) as a result of which the corporation, on or about December 1, 1961, sold certain real property it owned which was not being used in the conduct of its business and from the net proceeds of that sale satisfied all of its obligations to Mr. Snider (R.T. 13-14, 116-117).

On January 30, 1962, Mahl Associates, Inc. filed its voluntary petition in bankruptcy (R.T. 15).

This suit, judgment for plaintiff, and appeal by defendant, followed.

III.

ARGUMENT

A. Introduction.

At the outset it must be emphasized that this is not the typical preference case where the trustee is seeking to recoup moneys for the benefit of the bankrupt's general creditors. Any recovery here will apply to the bankrupt's taxes which are the personal obligation of plaintiff's chief witness, Kenneth Mahl (R.T. 37-38, 99-100). This action was in effect prosecuted for Mahl's personal benefit.

Another important preliminary point should be made. There is no doubt that defendant's principal problem in this Court lies in the adverse findings of the trial court which defendant must establish were clearly erroneous. (Rule 52, Federal Rules of Civil Procedure.) But again, this is not the typical case. There is a presumption that payments made by a bankrupt to its creditors are valid and that the creditor who received the payment was acting in good faith. (3 Collier, Bankruptcy, §§ 60.54, 60.62, pp. 1074, 1127.) In deciding that this presumption was overcome by plaintiff, the Court in its memorandum opinion did not rely upon the testimony of plaintiff's witnesses as to the financial condition of the bankrupt at the time of the transfer. Instead, ultimate reliance was placed upon the obvious insolvency as of the date of the petition in bankruptcy, from which the Court inferred by use of the doctrine of "retrojection" that insolvency in the bankruptcy sense existed two months prior to the petition when the transfer to defendant was consummated (T.R. 45). On the question of defendant's knowledge of insolvency, the Court also refrained from relying upon the testimony of plaintiff's witnesses that this knowledge was actually imparted to defendant. Rather, the Court inferred that, under the circumstances, the defendant had reasonable cause to believe that the corporation was insolvent (T.R. 47).

Due to the fact that these key findings are based upon inferences drawn from basically undisputed facts, this Court is free to independently evaluate the alternative inferences to which these facts give rise and to determine the validity of the inferences relied upon by the trial court. In Mayo v. Pioneer Bank & Trust Company (5th Cir. 1961) 297 Fed.2d 392, 395, it was held,

"Under Rule 52(a) of the Federal Rules of Civil Procedure 28 USCA the trial judge's findings of fact are conclusive unless clearly erroneous, but when the factual determination is primarily a matter of drawing inferences from undisputed facts or determining their legal implications, appellate review is far broader than where disputed evidence and questions of credibility are involved. (Citations omitted.) Our scope of review in this case is broad since the decision turns not on what the (defendant) in fact believed, but on what (he) had reasonable cause to believe; and most of the basic facts are undisputed."

In Moran Brothers, Inc. v. Yinger (10th Cir. 1963) 323 Fed.2d 699, 702, Rule 52(a) was interpreted as follows:

"" ** * A finding is "clearly erroneous" when although there is evidence to support it the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" (Citation omitted.)

B. Plaintiff Failed to Prove That the Bankrupt Was Insolvent at the Date of Transfer.

To show insolvency on the date of transfer, plaintiff was bound to prove that the bankrupt's liabilities exceeded its assets. This is a strict balance sheet test, and the mere showing of a working capital deficiency is immaterial. (1 Collier, *Bankruptcy*, § 1.19[1], p. 90.)

In finding that the corporation was insolvent in the bankruptcy sense on the date the debt was repaid to Mr. Snider, the trial court ignored the testimony of Mahl and other witnesses for plaintiff as to the financial condition of the business and instead found insolvency on the crucial date by use of the doctrine of "retrojection" (T.R. 45).

Two elements are essential to the application of that doctrine: (1) At the time of filing the petition in bankruptcy the liabilities must greatly exceed the assets and (2) there must be good reason to assume that there had been no substantial change in the status of the business with respect to assets and liabilities between the date of the transfer and the date of filing the petition. (1 Collier, Bankruptcy, § 1.19[3]-[5], p. 125.)

The primary reasons why the lower court found it necessary to apply this doctrine apparently lies in the fact that the testimony of plaintiff's witnesses as to the financial condition of the business at the time of the transfer was confused and self-contradictory, and that prior to trial Mahl destroyed the corporate books and records, according, he claims, to the instructions of the trustee in bankruptcy! (R.T. 18)

In reaching the conclusion that the bankrupt was insolvent on the date of transfer, the trial court relied on testimony by Mahl that there had been no substantial change in the assets and liabilities of the business between the transfer on December 1st and the filing of the petition on January 30th (R.T. 76). The Court very significantly rejected Mahl's testimony that as early as July and August of 1961 his corporation was insolvent (R.T. 20-21). Mahl later admitted having submitted a financial statement to the Cali-

fornia Commissioner of Corporations showing a net worth of \$139,000 as of June 30, 1961 (R.T. 21-22). Despite this "insolvency" Mahl failed to disclose it to prospective lenders from whom he was seeking money "right up until he filed bankruptey." (R.T. 25-26, 46-47, 61)

The conclusion is inescapable that Mahl either made false representations to the prospective lenders, including the Small Business Administration, the Commissioner of Corporations, and defendant Snider, or he was not truthful to the lower court.

Additionally, Mahl later said that he did not know the true condition of the company until the schedule of assets and liabilties appended to the bankruptcy petition was prepared in January of 1962 (R.T. 78), that he did not know the state of the books in September and October of 1961 (R.T. 85), that he did not know whether the company had a positive net worth in October and November of 1961 (R.T. 81), and, in response to a question from the Court, that he did not believe the company was insolvent in September and October of 1961 (R.T. 85).

Mr. Liu, a business associate of Mahl (R.T. 121), shared office space with Mahl through November and December of 1961 (R.T. 32, 119). Mr. Liu testified that Mahl never told him that the company was insolvent or on the brink of bankruptcy in the later months of 1961, that he first learned that the business was going into bankruptcy around the beginning of 1962 (R.T. 120-121), and that this came as a surprise to him (R.T. 121).

It seems obvious that until the bankruptcy petition was actually filed there were substantial potential assets that could be realized upon by the corporation as a going business. The financial statements submitted to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of June 30, 1961, demonstrated to the California Commissioner of Corporations as of

strate this (Deft's Exh. A). Not until the petition in bank-ruptcy was filed were assets such as advances to salesmen, equity in inventory, coin-operated laundries for resale (work in process), advances against salesmen's commissions, and reserves on sales contracts discounted with finance companies irretrievably lost. (See R.T. 23-25) In addition, upon the filing of the bankruptcy petition, accounts and notes receivable always drastically deteriorate in value.

This record does not support the district court's finding that it is "an inescapable conclusion that the bankrupt was insolvent at the time of the transfer." (T.R. 45, 49) The Court erred in applying the theory of retrojection since there was no good reason to assume that the status of the business had not changed from the date of the transfer to the date of filing the petition. And without the benefit of the theory of retrojection the trial court would not have found insolvency on the crucial date.

C. Defendant Did Not Have Reasonable Cause to Believe That the Bankrupt Was Insolvent at the Time of Transfer.

1. THE CASES.

In its memorandum opinion the trial court expressly declined to find that defendant Snider had actual knowledge of insolvency on December 1, 1961 when he received payment of the debt owing him (T.R. 46). The court found in favor of plaintiff on this essential element of a preference by determining that Mr. Snider had reasonable cause to believe that Mahl Associates was then insolvent (T.R. 47).

With respect to Mahl's testimony, some of which is above summarized, the court said that as president of the corporation he thought that the principal problem was a lack of working capital, that he was an almost incurable optimist in his business dealings, and that the corporation was suffering from greater financial problems than he was willing to admit (T.R. 46). In effect, the trial court said that although Mahl may not have known that his company was insolvent in the bankruptcy sense, Mr. Snider should have known this fact.

The court does not point in its memorandum opinion to the evidence upon which it relied in reaching this conclusion. The trial court merely cited the customary test that when financial information is brought to a creditor's notice which would lead a prudent business person to the conclusion that the debtor is insolvent then that creditor has reasonable cause to believe the debtor is insolvent (T.R. 47).

The evidence, at best, establishes that Mr. Snider had reasonable cause to suspect or be apprenhensive about the possibility that the corporation was insolvent. But, "apprehension or suspicion on the part of the creditor is not sufficient to constitute the 'reasonable cause to believe' which is required by section 60 of the Act." (3 Collier, Bankruptcy, § 60(2), p. 1066; see 8A Corpus Juris Secundum, Bankruptcy, § 215(3)(b), p. 23.)

This test was discussed in Cate v. Certainteed Products Corporation (1943) 23 Cal. 2d 444, 449, 144 P.2d 335, as follows:

"A man may have many grounds of suspicion that his debtor is in failing circumstances, and yet have no cause for a well-grounded belief of fact. He may be unwilling to trust him further; he may feel anxious about his claim, and have a strong desire to secure it and yet still belief as the Act requires may be wanting. Obtaining payment of a debt under such circumstances is not prohibited by the law. * * * Hundreds of men constantly continue to make payments up to the very eve of their failure, which it would be very unjust and disastrous to set aside. * * * The debtor is often buoyed

up by the hope of being able to get through with his difficulties long after his case is in fact hopeless and his creditors, if they know anything of his embarassments, either participate in the same feeling, or at least are willing to think that there is a possibility of his succeeding. To overhaul and set aside all his transactions with his creditors, made under such circumstances because there may exist some grounds of suspicion of his inability to carry himself through, would make the Bankruptcy Act an engine of oppression and injustice."

Moreover, even if the evidence, hereafter discussed, could be said to give rise to the inference that Mr. Snider had reasonable cause to believe that insolvency existed, it also gives rise with at least equal persuasion to an inference that Mr. Snider had reasonable cause to believe that Mahl Associates was not insolvent but that the corporation was merely short of working capital. In *Engelkes v. Farmers Co-Operative Company* (D.C. N.D. Iowa 1961) 194 F. Supp. 319, 329 the rule was stated as follows:

"Where inferences from proved facts are to be drawn, the rule obtains that if two inferences of substantially equal weight may reasonably be drawn from the proved facts, then that inference shall prevail which sustains the transfer."

(See also 3 Collier, *Bankruptcy*, § 60.62, p. 1127 and cases there cited.)

In the preference cases which have found knowledge of insolvency or reasonable cause to believe that insolvency existed the defendant had knowledge of facts which are not present in this case:

"Undercapitalization of the debtor, sales below cost, checks drawn on a bank account and payment refused by reason of insufficient funds, a consistent pattern of overdrafts, operating losses, irregular, unusual or criminal conduct, secretiveness, slow payment, collection measures taken by other creditors, rescue of the debtor from embarrassment by friends or relatives, and reliance on financial statments or reports." (Dean v. Planters National Bank of Hughes (D.C.E.D. Ark. 1959) 176 F. Supp. 909, 914.)

It is, of course, well settled that the existence of an overdue indebtedness or knowledge that the debtor is experiencing financial difficulty in meeting current obligations is not sufficient to charge the creditor with having reasonable cause to believe that insolvency exists. (3 Collier, Bankruptcy, § 60.54, p. 1076.) Nor does the transfer of a debtor's assets to satisfy an obligation require a finding that the transferee has reason to be aware of insolvency. (Employers' Mutual Casualty Company v. Hinshaw (8th Cir. 1962) 309 Fed. 2d 806; Cowan, Bankruptcy and Practice, § 752, p. 402.)

In each of the following preferences cases, on evidence considerably more favorable to the plaintiff than the evidence in the instant case, the courts refused to find reasonable cause to believe that insolvency existed:

Moran Brothers, Inc. v. Yinger (10th Cir. 1963) 323 Fed. 2d 699: The court of appeals reversed the district court's finding of reasonable cause to believe where the evidence established that:

- (1) The debtor failed to meet the obligation of making an escrow deposit;
- (2) The debtor advised the defendant that funds were not available to be deposited to meet such obligation;
- (3) The debtor gave postdated checks in payment of the obligation;

- (4) The defendant expressed concern that the debtor would be unable to complete payment and said that he wanted funds at that time; and
- (5) Payment on the postdated check was refused for insufficient funds when presented for payment.

Lang v. First National Bank of Houston (5th Cir. 1954) 215 Fed. 2d 118: No reasonable cause to believe insolvency existed even though:

- (1) The defendant knew of the debtor's inability to meet current obligations;
- (2) The debtor was in need of working capital and obtained loans from the defendant;
- (3) The debtor had in the past generally repaid loans to the defendant when due, but had occasionally been somewhat late;
- (4) The debtor was more than two weeks overdue on a current note to the defendant at the time the alleged voidable preference was made; and
- (5) The defendant knew that the debtor-contractor had several lucrative jobs of substantial value in progress!

The court placed great emphasis on this latter factor:

"To be sure, the appellee (creditor) knew that the bankrupt was having difficulty meeting current obligations which, after all, was the reason working capital was needed. But it also knew that the bankrupt had several lucrative jobs in progress and that some were near completion. . . . The bankrupt showed the appellee's officer that there were more than a half million dollars in retainages on one job alone, explaining that receipt of this amount would remedy the situation considerably." (P. 120.)

The existence of jobs in progress is a "crucial" factor (see Mayo v. Pioneer Bank & Trust Company (5th Cir. 1961) 297 Fed. 2d 392, 397); that factor is also present in our case (R.T. 111-112, 113).

Sumner v. Parr (D.C.S.D. N.Y. 1919) 270 Fed. 675: Findings were made in favor of the preferred defendant even though:

- (1) He had not attempted to ascertain the value of the bankrupt's business and real estate holdings;
- (2) He knew the bankrupt was slow in payments and had been for some time;
- (3) He had been obliged to take notes from the bankrupt when the bankrupt could not make prompt payment; and
- (4) He had become suspicious of and unsatisfied with the bankrupt's delays and had demanded and obtained security for the debt.

The court noted, "[T]here were no immediate suspicious circumstances. Nothing had just happened which should have caused (defendant) to suppose that the bankrupt was any nearer insolvency than she had been for some time." (P. 676.)

Engelkes v. Farmers Co-Operative Company (D.C.N.D. Iowa, 1961) 194 F. Supp. 319: No reasonable cause to believe insolvency existed where:

- (1) The defendant was informed by the bank that the bankrupt was a "thin operator";
- (2) The check given by the bankrupt to the defendant in payment of its obligation was twice refused payment for insufficient funds;
- (3) Defendant was informed that other checks issued by the bankrupt were being refused payment on the grounds of insufficient funds;
- (4) Defendant pressed the bankrupt hard for payment and gave the bankrupt an ultimatum and threatened that the account would be turned over to an attorney for action; and

(5) Defendant knew that the bankrupt had given him erroneous information regarding accounts receivable.

These facts were found to support inferences both of insolvency as well as mere financial difficulty:

"'As one views any business failure in the retrospect, many incidents and circumstances bearing upon a bankrupt's financial condition loom much larger and more formidable than they did before the crash occurred. All well considered cases have enunciated the doctrine that mere apprehension on the part of the creditor is not equivalent to good cause to believe that insolvency exists * * * " (Citations omitted; p. 329.)

Salter v. Guaranty Trust Company of Waltham [D.C. Mass. 1956] 140 F.Supp. 111: The court found no reasonable cause to believe notwithstanding the following facts:

- (1) The bankrupt failed to repay a loan to defendant bank when due and then obtained a renewal of that loan;
- (2) The bankrupt's account balance at defendant bank continually declined and eventually became overdrawn;
- (3) There was a great deal of work in progress which the bankrupt said would result in funds to pay off the obligation;
 - (4) The renewal loans were paid off before maturity;
- (5) A writ against the bankrupt was served on the defendant bank; and
- (6) The defendant bank knew throughout that the bankrupt lacked ready cash to pay its bills when due.

Cate v. Certainteed Products Corporation (1943) 23 Cal. 2d 444, 144 P.2d 335: Determination of no reasonable cause to believe was based upon the following evidence:

- (1) The obligation owed to defendant was four months overdue:
- (2) Credit reports showed the bankrupt as customarily slow in paying his obligations;

- (3) A credit agency advised defendant that the bank-rupt's account should be watched closely;
- (4) Defendant was advised of the bankrupt's intention to have a bulk sale of its stock in trade;
- (5) Defendant discovered that the bankrupt's place of business was under attachment;
- (6) The bankrupt had a large amount of accounts receivable but was slow in making collections;
- (7) A compromise and settlement of the account was reached as a result of which the bankrupt gave defendant a postdated check which was subsequently twice refused for insufficient funds and was, upon defendant's demand, replaced by a certified check at a time when the debtor stated he was solvent and that he intended to stay in business by changing the character of his operations.

2. THE EVIDENCE.

In this case the evidence before the trial court showed that at the time of the December 1, 1961 transfer the bankrupt had owed Mr. Snider some \$1,200 since July of 1961 (R.T. 8, 109) and some \$4,200 since mid-September of 1961 (R.T. 8, 109); that the bills represented costs of alterations and construction of additional office space for the corporation's expanded operations (R.T. 8, 109); and that Mr. Snider had been owed \$10,000 for a loan of working capital since mid-September (R.T. 10, 111). The evidence also was that although the corporation had been customarily late in paying the rent it had paid through the month of October (R.T. 112-113); that the entire obligation to Mr. Snider was being satisfied by real property owned by the corporation but undeveloped and not used in its business (R.T. 10, 13, 116-117); that the corporation had substantial assets which were dependent upon its continuing in business (R.T. 23, 111); that Mr. Liu, a business associate of Mahl, who shared office space with the corporation, had no suspicions at that time of bankruptcy (R.T. 121); and that Mahl himself did not really believe that the corporation was insolvent (R.T. 85-86).

Much was said at the trial concerning a purported conversation between Mahl and Mr. Snider in October of 1961 (R.T. 11-12, 34-37, 113, 117-118). At one point in the record Mahl stated that he told Mr. Snider, "that I was insolvent and it had been suggested by my accountant and attorney to file a petition in bankruptcy." (R.T. 13) The trial court in its memorandum opinion gave little, if any, credence to this testimony. Mr. Snider denied any such statement was made (R.T. 113); he said that Mahl did tell him that he was unable to pay the debts because he was "temporarily short of cash." (R.T. 114) Significantly, Mahl was soliciting funds from Mr. Snider during this period (R.T. 47), and Mahl stated flatly that he would not have asked Mr. Snider for additional funds if he had told him of any impending bankruptev (R.T. 47). French, a business associate of Mahl at the time of trial (R.T. 62), as well as a vice president of the bankrupt corporation (R.T. 50), also testified that Mahl tried to induce Mr. Snider to invest in the business in October (R.T. 65). Obviously Mahl was not seeking more money from Mr. Snider at the same time he was forecasting financial ruin to this prospective lender.

In his deposition prior to trial Mahl said that he "did not recall" any conversation with Mr. Snider after September 15, when the note became due (R.T. 35-36), and that he did not tell Mr. Snider that the business was broke (R.T. 36-37).

During this time Mahl was soliciting loans from other sources as well yet said he did not tell these other sources of imminent financial disaster (R.T. 46-47; 61).

The complete explanation for this conversation (between Mahl and Mr. Snider), if it occurred at all, was provided by French, plaintiff's witness. According to French Mr. Snider was told that unless financing were obtained Mahl had been advised to institute bankruptcy proceedings (R.T. 51). Also according to French, Mr. Snider was merely informed "that we needed working capital." (R.T. 65) Such statements are entirely consistent with the present existence of a positive net worth of a going business, based on receivables, work in progress, and similar assets, which Mr. French said did in fact exist in October and November (R.T. 58). French at that time believed that the corporation was solvent (R.T. 53-54; 58). Solvency in the bankruptcy sense may exist even though working capital might not exist. (1 Collier, Bankruptcy, § 1.19[1], p. 90.)

D. The Court Erred in Excluding the Evidence Offered by Defendant Through Messrs. Holderby and Vedovie.

In its memorandum opinion the district could quoted from the recent decision of this Court in *I-T-E Circuit Breaker Company v. Holzman* (9th Cir. 1965) 354 Fed. 2d 102, 105: "A creditor may not close his eyes in order to remain ignorant of the debtor's true condition; and the creditor is chargeable with notice of all facts which a reasonably diligent inquiry would have disclosed." (T.R. 47)

What would a reasonably diligent inquiry have revealed to Mr. Snider? The testimony and exhibits which the prospective witnesses Holderby and Vedovie would have provided, had the court permitted the introduction of this evidence, could have answered this question. It was reversible error, for that reason, to exclude the evidence.

Mahl Associates, the debtor corporation, did business with the Mills (Burlingame) office of the Bank of Califor-

nia. Mr. Holderby, the assistant manager of that branch, testified that the bank's credit file on Mahl Associates contained responses by the bank on November 15, 1961, and October 27, 1961, to credit inquiries addressed to the bank by other prospective lenders to the corporation (R.T. 102; Deft's Exh. C for identification).

Had he been permitted to testify, Mr. Vedovie, a real estate broker who represented the purchaser of the real property occupied by Mahl Associates, would have testified that his principal's purchase price was based upon the \$800.00 rent Mahl Associates had been paying and that as of the date of the alleged preferential transfer (December 1, 1961) he had concluded from credit inquiries through his bank and through Dun & Bradstreet that Mahl Associates was then a reasonably sound tenant (R.T. 121).

This evidence, if received, would have established beyond doubt that a reasonably diligent inquiry by Mr. Snider would not have revealed insolvency of the corporation; on the contrary, it would have indicated just the opposite.

If Mr. Snider would have been even more curious, what would Mahl and his associates have revealed? Mahl himself did not believe he was insolvent (R.T. 85), nor did French, his principal financial adviser (R.T. 53-54, 58). If Mr. Snider had asked to see the books of the corporation they would have revealed little, if anything, since they were not in shape and financial statements had not been prepared since the preceding June 30 (R.T. 24, 52, 85). Mahl testified that until the schedules were prepared for the petition in bankruptcy he had no accurate idea of what financial condition the business was in (R.T. 78, 85).

IV.

CONCLUSION

To establish a voidable preference under § 60 of the Bank-ruptey Act it was incumbent upon plaintiff to prove by a fair preponderance of the evidence two vital elements, the existence of which are disputed, namely, (1) that Mahl Associates was insolvent on December 1, 1961, and (2) that Archie Snider had reasonable cause to believe that Mahl Associates was then insolvent.

Plaintiff's evidence of these elements must be so strong as to overcome the presumptions that the transfer was valid and was received by Mr. Snider in good faith. (3 Collier, Bankruptcy, §§ 60.54, 60.62, pp. 1074, 1127.) Moreover, the scope of review in this case is particularly broad since the decision below turned not on what Mr. Snider actually believed but on what he had "reasonable cause" to believe, and most of the facts are undisputed. Mayo v. Pioneer Bank & Trust Co., supra, 297 Fed. 2d 392, 395.

Plaintiff failed to meet these tests. He failed to prove that the business had not substantially changed from the date of the transfer to the date of the filing of the bank-ruptcy petition. This being the case, the trial court erred in applying the doctrine of retrojection and in finding that the bankrupt was insolvent on the date in question.

Plaintiff failed to prove that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the crucial date. The evidence establishes at best only that he had reasonable cause to suspect or be apprehensive of insolvency. The trial court's finding that the defendant had reasonable cause to believe that the bankrupt was insolvent on the date in question is therefore unsupported by the evidence. The trial court inferred from the facts that defendant had reasonable cause to believe the corporation was insolvent. The evidence sustains with at least equal weight the inference that Mr. Snider had reasonable cause to be-

lieve, and did believe, that the bankrupt was merely temporarily short of working capital and not insolvent. Thus, the court erred in failing to apply the rule that if two inferences of substantially equal weight may reasonably be drawn from the proven facts, then that inference shall prevail which sustains the transfer. (Mayo v. Pioneer Bank & Trust Company, supra, 297 Fed. 2d 392, 395.)

Finally, the court erred in excluding evidence presented on behalf of Mr. Snider which would have shown that any inquiry by him into the financial condition of the bankrupt not only would have given no knowledge or reasonable cause to believe insolvency existed but would have affirmatively reinforced his belief that the bankrupt was merely temporarily short of working capital.

For each and all of these reasons the judgment must be reversed.

Dated: August 19, 1966.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN F. TAYLOR
Attorney for Appellant

No. 20,981

IN THE

United States Court of Appeals For the Ninth Circuit

John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee.

VS.

ARCHIE Symer, individually and dba Snider Construction Co.,

Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California

BRIEF OF APPELLEE, JOHN M. ENGLAND, AS TRUSTEE OF THE ESTATE OF MAHL ASSOCIATES, INC., A CORPORATION, BANKRUPT FILED

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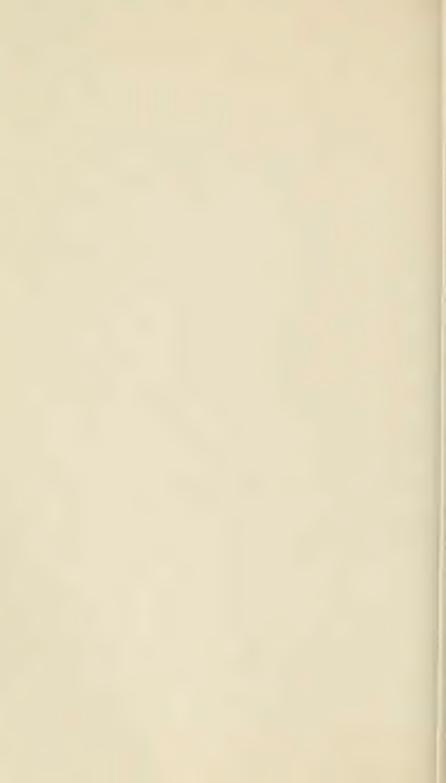
John M. England, as Trustee of B. B. LUCK CLERN the Estate of Mahl Associates, Inc., a corporation, Bankrupt.

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IN THE

United States Court of Appeals For the Ninth Circuit

John M. England, as Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

VS.

Archie Snider, individually and dba Snider Construction Co.,

Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California

BRIEF OF APPELLEE, JOHN M. ENGLAND, AS TRUSTEE OF THE ESTATE OF MAHL ASSOCIATES, INC., A CORPORATION, BANKRUPT

I. PRELIMINARY MATTERS

A. Jurisdiction

This is an action by the Trustee of a bankrupt estate to recover a preferential transfer alleged to have been made in favor of the defendant. The District Court obtained jurisdiction by virtue of Sections 60 and 67 of the Bankruptcy Act (11 U.S.C. 96, 11

U.S.C. 107). Defendant appealed to this Court from an adverse judgment pursuant to Rule 73, Federal Rules of Civil Procedure.

B. Statement of Facts

Mahl Associates, Inc., a California corporation, was duly adjudged bankrupt by the Court below on January 31, 1962. Appellee here is the Trustee of that bankrupt estate. On April 15, 1961, Appellant leased to the bankrupt the premises upon which the bankrupt had its principal place of business, and these premises thereafter remained the principal place of business of the bankrupt up until the time it filed its Petition in Bankruptcy. Some time before August 1, 1961, Appellant made certain improvements in and to the premises to accommodate the bankrupt's business, and the Appellant thereafter billed the bankrupt for such work in the sum of \$5,492.02. Thereafter, on August 15, 1961, Appellant loaned \$10,000 to the bankrupt in order that the bankrupt could meet its payroll. At the time of the loan the bankrupt executed its unsecured promissory note dated August 15, 1961 in the sum of \$10,000, payable thirty days from its date. The balance due on the note, plus interest thereon, and the amount due for the leasehold improvements were paid to Appellant on or about December 1, 1961 out of the proceeds of the sale of a parcel of real property owned by the bankrupt.

II. ARGUMENT

A. INTRODUCTION

Appellee wishes to briefly reply to the statements of Appellant found under the heading "Introduction" on page 6 of his Opening brief.

Appellant's reference therein as to what will be done with the moneys Appellee may recover herein are inappropriate. The Appellee is duty bound as the Trustee of a bankrupt estate to seek recovery of all funds which may be due the estate, and this duty applies to the recovery of preferential transfers (11 U.S.C. 96). Furthermore, how the moneys are distributed once they are recovered by the Trustee has been decreed by Congress in the Bankruptcy Act. If Congress has deemed that the United States receive priority payment on account of taxes due it, then the Trustee must comply with such decree. The fact that one of the principals of the corporation is thereby relieved of personal liability for such taxes paid (an obligation which he could not meet in any event) should not influence the Court as to whether or not there has been a voidable preferential transfer and the mention of this fact has no place in this appeal.

Appellant makes reference to the doctrine of "Retrojection" used by the Trial Court to determine insolvency at the time of the transfer. We shall discuss this below when discussing the evidence in support of the challenged finding of such insolvency. Contrary to that which is stated in Appellant's "Introduction," the findings are amply supported by the evidence as we shall demonstrate below.

B. IT IS AGREED BY THE PARTIES THAT CERTAIN OF THE ELEMENTS OF A VOIDABLE PREFERENCE REQUIRED TO BE PROVED HAVE SO BEEN PROVED.

In order to establish that a voidable transfer has been made, it is incumbent upon Appellee to establish all of the required statutory elements, to wit: (1) a transfer of the debtor's property; (2) for the benefit of a creditor on account of an antecedent debt; (3) while the debtor is insolvent; (4) within four (4) months of bankruptcy; (5) the effect of which transfer was to enable the creditor to obtain a greater percentage of his debt than other creditors of the same class; and (6) that the creditor had reasonable grounds for believing the bankrupt insolvent at the time he received the transfer. 3 Collier on Bankruptcy, 14th Edition, Section 60.02, page 755 et seq. It is conceded by Appellant that the Appellee has sustained his burden with reference to proof of these elements except as to numbers 3 and 6. This Brief shall be therefore addressed to the question of whether the evidence supports the finding that elements 3 and 6 have been proved.

C. APPELLEE ESTABLISHED THAT THE BANKRUPT WAS INSOLVENT ON THE DATE OF TRANSFER.

Section 1 of the Bankruptcy Act (11 U.S.C. 1) defines insolvency as existing when the aggregate of one's property, exclusive of property which he has conveyed, is not sufficient to pay one's debts. Was this the condition of Mahl Associates on or about December 1, 1961, the date when the subject transfer was made,

and a bare two months before adjudication? The record fairly shouts an affirmative answer to this question. The Trial Court so found (Finding of Fact No. 9) and on appeal this and all other findings of fact must be presumed to be correct and should not be set aside unless clearly erroneous. Fed. Rules of Civ. Proc., Rule 52. Such findings are presumptively correct and should not be disturbed if supported by substantial evidence. American Alliance Insurance Co. v. Brady Transfer and Storage Co., 101 F 2d 144, Alliance Ins. Co. of Philadelphia v. Brown, 36 F 2d 625.

It is not disputed that the bankrupt was insolvent on the date of adjudication, January 31, 1962. Nothing significant had occurred in the two months previous to adjudication. Mr. Mahl, president and general manager of the bankrupt, testified that as far back as September and October, 1961, the business was defunct (R.T. 16). Mr. Mahl further testified that between the latter part of November, 1961 and January 29, 1962, the date on which he signed the Bankruptcy Petition, there was no substantial change in the asset liability ratio of Mahl Associates (R.T. 76). Mr. Leonardo S. Bacci, an attorney at law, testified that he examined the books of Mahl Associates in the latter part of September, 1961 and as a result of such examination advised Mr. Mahl that Mahl Associates should file a Petition in Bankruptcy (R.T. 87-88). Mr. Bacci further testified that the information upon which he based his advice in September 1961 was substantially the same information he used in ultimately preparing the bankruptcy schedules of Mahl Associates, which schedules were thereupon filed in the Court below (R.T. 91-92).

Appellant cannot seriously contend that on the date of adjudication Mahl Associates was not insolvent within the meaning of the Bankruptcy Act. As of the date of the trial of this action, the money on hand in the bankrupt estate was \$2478.99. The only other assets consisted of a judgment for \$3,000, a sum which might be recovered from a Morris Plan Reserve Account not to exceed \$5,000, and whatever might be collected in this present litigation. The unpaid creditors' claims at that time approximated \$180,000 (R.T. 98-99). The evidence demonstrates that this was also essentially the condition of the bankrupt at the time of the transfer. That Mr. Mahl was attempting to obtain capital to put into the corporation up until the time of bankruptcy does not detract from the validity of Appellee's position, but rather strengthens it. If Mahl had been able to obtain such additional financing before the transfer, then perhaps it would be arguable that Mahl Associates was solvent on the date of transfer. But the fact remains that even though Mr. Mahl may have attempted to obtain money right up until adjudication (as Appellant states on page 9 of his Opening Brief, which statements are unsupported by the citations given) he was unable to obtain such financing. No substantial business was done in the three months before adjudication, and beginning in October, 1961 Mahl Associates operated with a skeleton crew (R.T. 47-48). The loans Mr. Mahl was seeking on behalf of Mahl Associates simply did not matterialize. That Mr. Mahl was seeking money or that he was optimistic with regard to obtaining financing does not change the actual fact of insolvency. Upon adjudication, whatever potential assets Mahl Associates might have had (as referred to on pages 9 and 10 of Appellant's Opening Brief) became the property of plaintiff herein. It has been conclusively demonstrated above that Mahl Associates had substantially more debts than assets on the date of adjudication, including such potential assets.

As the Trial Court so aptly put it on page 4 of its Memorandum of Opinion on file herein, "It appears to be an inescapable conclusion that the bankrupt was insolvent at the time of the transfer of the real property or alleged preference."

D. DEFENDANT HAD REASONABLE CAUSE TO BELIEVE THAT THE BANKRUPT WAS INSOLVENT AT THE TIME OF THE TRANSFER.

Whereas in establishing insolvency it is the actual condition of the bankrupt at the time of the transfer that is important, in establishing reasonable cause it is the reasonable belief of the transferee that is relevant. The Trial Court found there was reasonable cause for defendant to believe that Mahl Associates was insolvent on the date of the transfer. The record supports this finding.

Mr. Mahl testified that in October 1961 he had a conversation with defendant at which time and place

a Mr. French, a then employee of Mahl Associates, was present. At that time Mr. Mahl told Appellant that Mahl Associates was insolvent and that he had been informed by his attorney and his accountant to file a Petition in Bankruptcy on behalf of Mahl Associates (R. T. 12-13), Mr. Mahl then testified that he told Appellant that the only asset out of which he could be paid was a parcel of real property (R.T. 13). Mr. French corroborated this testimony (R. T. 50-51). It is true that Appellant denied that this conversation took place, but it is elementary that the decision of the Trial Court as to the credibility of witnesses is presumptively correct. Metro-Goldwyn-Mayer Corporation v. Fear, 104 F 2d 892. It has also been held by this Court that the acceptance of testimony by the Trial Court observing the witness on the stand is conclusive on appeal as regards credibility. Larsen v. Portland California S. S. Co., 66 F 2d 326. The Trial Court here clearly found that this conversation took place in spite of Appellant's denial. On page 3 of the Trial Court's Memorandum Opinion it is stated: "Although there is some conflict in the evidence, it appears that Mahl told defendant the business was insolvent and needed recapitalizing. It also appears that in October Mahl informed the defendant of insolvency and that an accountant and an attorney had suggested bankruptey." It is true, the Trial Court states it did not base its decision on the fact that at the time of the transfer Appellant had actual knowledge of insolvency although the Court found such actual knowledge to exist (Memorandum Opinion,

page 5). But, as stated above, actual knowledge of insolvency is not required, only reasonable cause to believe such insolvency.

The record also reflects that the bankrupt borrowed \$10,000 from Appellant to meet payroll, and a thirtyday note was thereby executed by the bankrupt (R.T. 9). There were several conversations between Mr. Mahl and Appellant after the note became due, wherein Appellant demanded payment and Mahl stated that the bankrupt was unable to pay (R. T. 11). Appellant agreed to accept payment out of the proceeds of the sale by the bankrupt of a parcel of real property (R.T. 13-14). At the time of the repayment, the bankrupt owed Appellant back rent from November 1, 1961 (R.T. 113) and the rent for previous months had consistently been paid late (R.T. 116). By virtue of the proof referred to herein and the undisputed facts now before this Court, it has been established that the Appellant was aware of the following at the time he was paid: 1) his loan to the bankrupt was given so that the bankrupt could meet its payroll; 2) the construction bills were already seven and five months overdue; 3) the note for \$10,000, although due on September 15, 1961, had not been paid; 4) the bankrupt had ceased paying its rent; 5) not even a partial payment had been made on the obligations owing Appellant by the bankrupt; 6) Appellant had been informed that it would be necessary for the bankrupt to sell a capital asset in order to pay him; and 7) previous to payment Appellant had been informed by Mr. Mahl that Mahl Associates was insolvent and

that Mr. Mahl had been advised by an accountant and an attorney to file a Petition in Bankruptcy on its behalf.

In the very recent case of *I-T-E Circuit Breaker Company v. Holzman*, 354 F 2d 102, this Court stated on page 105 of the opinion,

"... The test of when a creditor has such reasonable cause has often been said to be when such a state of facts is brought to the creditor's notice, respecting the affairs and pecuniary condition of the debtor, as would lead a prudent business person to the conclusion that the debtor is insolvent. (Citations omitted) A creditor may not close his eyes in order to remain ignorant of the debtor's true condition; and the creditor is chargeable with notice of all facts which a reasonably diligent inquiry would have disclosed." (Citations omitted)

The Court in *I-T-E Circuit Breaker*, supra, upheld the Trial Court's decision that a preferential transfer had been made on substantially less evidence of reasonable cause to believe than is present here. In that case the Trial Court based its finding on the facts that 1) though Appellant repeatedly requested financial statements from the bankrupt, none was ever submitted; 2) before the alleged preferential transferee knew the bankrupt was factoring its accounts; 3) the transferee knew that the bankrupt was consistently delinquent in meeting its bills from the transferee. The case at bar is substantially stronger in that the creditor had actually been informed before the transfer that the bankrupt had been advised

by an accountant and an attorney to file a Petition in Bankruptcy. This very significant fact alone sets the present case apart from any of the cases cited by Appellant in his Brief. How, on this state of this record can it be said that the District Court was clearly erroneous in finding that Appellant had "reasonable cause to believe?"

E. THE COURT DID NOT ERR IN EXCLUDING THE EVIDENCE OFFERED BY APPELLANT THROUGH MESSRS. HOLDERLY AND VEDOVIC.

Appellant now asserts that the offered testimony of Messrs. Holderly and Vedovic was offered to prove that if Appellant had made a reasonable diligent inquiry into the affairs of Mahl Associates, such inquiry would not have revealed to Appellant that Mahl Associates was insolvent. Appellee believes that this argument has no merit whatsoever and that it borders on frivolity. When the testimony of these two gentlemen was offered, Appellee objected to their testifying on the ground that the names of these proposed witnesses were not set forth on the pre-trial statement as potential witnesses (R.T. 101, 121). Appellant then claimed that the sole purpose of the offered testimony was impeachment, and under those circumstances it was not necessary to list them on the pre-trial statement (R.T. 101). It would have been improper for the Court to receive the testimony for the purposes now urged by Appellant even if such testimony were otherwise admissible or relevant.

Appellant offered to produce evidence of credit inquiries made by third parties to the Bank of California with reference to the bankrupt and the replies of the said bank. The now alleged purpose of this evidence was to demonstrate that if Appellant had made diligent inquiry the answer of the Bank of California might have revealed a condition other than insolvency. Aside of being opinion, conclusion and hearsay, this evidence would be irrelevant. The issue is not what Appellant might have been led to believe if he had acted diligently, but rather whether he had reasonable cause to believe the actual proved fact of insolvency according to what he did know. There is no evidence that Appellant made any inquiry to the Bank of California with reference to the financial condition of the bankrupt. What other creditors may have done and what information they may have garnered is wholly irrelevant to this case.

For the very same reasons, the proffered hearsay testimony of Ernest Vedovic was properly excluded. Furthermore, Appellant did not need a Dun and Bradstreet report to tell him how sound a tenant Mahl Associates was. Appellant himself as the landlord well knew that the bankrupt never paid its rent on time and that on the date of the transfer was at least a month in arrears on rent payments. Any information that Dun and Bradstreet might have had with reference to the bankrupt's rent-paying habits it must have gotten from Appellant.

III. CONCLUSION

Appellee respectfully submits that he has proved by substantial evidence all the elements of a voidable preference, and that the decision of the Court below was not clearly erroneous.

Dated, Burlingame, California, November 17, 1966.

Respectfully submitted,
Shapro, Anixter & Aronson,
By Henry Cohen,
Attorneys for Appellee,
John M. England, as Trustee of
the Estate of Mahl Associates,
Inc., a corporation, Bankrupt.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HENRY COHEN,

Attorney for Appellee,
John M. England, as Trustee of
the Estate of Mahl Associates,
Inc., a corporation, Bankrupt.



No. 20,981

In the

United States Court of Appeals

for the Ninth Circuit

John M. England, As Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

VS.

Archie Snider, individually and doing business as Snider Construction Co., Defendant and Appellant.

On Appeal from the United States District Court

Reply Brief of Appellant Archie Snider Individually and Doing Business as Snider Construction Co.

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In the

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John M. England, As Trustee of the Estate of Mahl Associates, Inc., a corporation, Bankrupt,

Plaintiff and Appellee,

VS.

Archie Snider, individually and doing business as Snider Construction Co., Defendant and Appellant.

On Appeal from the United States District Court for the Northern District of California

Reply Brief of Appellant Archie Snider Individually and Doing Business as Snider Construction Co.

I.

ARGUMENT

A. Introduction.

Throughout his brief plaintiff largely ignores the essential arguments advanced by defendant. In particular, plaintiff fails to answer the proposition that this Court has broad powers to review and reverse the findings of the

lower court in a case such as this. (Appt's Op.Br., p. 7.) Plaintiff also avoids defendant's contentions relative to the applicability of the doctrine of retrojection applied by the lower court. (Appt's Op.Br., p. 8.) In addition, plaintiff fails to comment upon the rule that when two equally persuasive inferences may be drawn from substantially undisputed facts, the inference upholding the transaction should be applied. (Appt's Op.Br., p. 12.) And finally, plaintiff avoids discussion of the many cases cited by defendant on the question of the necessary proof to support findings of reasonable cause to believe that insolvency exists.

Rather than discussing the issues thus raised, plaintiff's brief consists largely of a restatement of many facts and much testimony which he claims as supporting direct findings of insolvency and of actual knowledge by defendant of insolvency, neither of which, by plaintiff's own admission, did the trial court pass upon. (Re retrojection, see Appl's Br., p. 3; re actual knowledge, see Appl's Br., p. 8.)

Plaintiff's avoidance of these basic questions is significant and can only suggest that he is unable to refute defendant's argument pertaining to those questions.

Following are more specific replies to plaintiff's brief.

B. Insolvency.

Plaintiff argues that this Court is without power to overrule the lower court's finding unless it is "clearly erroneous." (Appl's Br., p. 5.) No doubt this is the general rule and it has been so recognized by defendant. (Appt's Op. Br., p. 6.) However, as pointed out in the Opening Brief, this Court's powers of review are much greater in this case because the decision below turns primarily upon inferences drawn from undisputed facts. (Appt's Op.Br., p. 7.) Plaintiff offers no reason why that rule should not apply here.

Plaintiff says also that there was no change in the financial condition of the bankrupt between the date of transfer and date of adjudication. (Appl's Br., pp. 5-6.) The only direct evidence on this point was Mahl's testimony. The other testimony plaintiff refers to is related to times prior to the date of transfer which have no bearing on the change of condition between the two crucial dates.

Plaintiff does not refute defendant's argument (Appt's Op.Br., pp. 8-10) that the doctrine of retrojection was improperly applied by the trial court here.

Plaintiff stresses the fact that the bankrupt never received the financing it was seeking during the months in question. He states that, "If Mahl had been able to obtain such additional financing before the transfer, then perhaps it would be arguable that Mahl Associates was solvent on the date of transfer." (Appl's Br., p. 6.) This demonstrates plaintiff's misunderstanding of the requisites of insolvency in the bankruptcy sense. The additional financing, had it been obtained, would not have altered the asset-liability status of the bankrupt at all. Rather, it would merely have strengthened its working capital position because the assets and liabilities would have been both equally increased. Likewise the inability to obtain such financing did not adversely affect the asset-liability status, but merely left the bankrupt in a weak working capital position. Such has been defendant's contention from the beginning.

Plaintiff concludes this part of his argument with the assertion that it was "conclusively demonstrated" that on the date of adjudication (not the date of the transfer two months previously) the bankrupt had more debts than the potential assets it claimed to have as a going business.

(Appl's Br. p. 7.) The apparent net deficit upon adjudication was about \$170,000. (Appl's Br., p. 6.) But if Mahl's statement of June 30, 1961, given to the California Corporations Commissioner is entitled to any credence, (Def's Exh. A), the following assets were available to the bankrupt as a going business but obviously lost or seriously impaired upon bankruptcy, as is well demonstrated by the bankrupt's schedules (see R.T. 22-25): Accounts receivable, \$69,000; Notes receivable, \$27,000; Advances to salesmen, \$5,000; Work in process (laundries for resale), \$79,000; Prepaid interest, \$3,000; Notes receivable (against salesmen's commissions), \$59,000; Furniture and fixtures, \$6,000; Deposits \$12,000; Organization expense, \$1,000; and Reserves on discounted sales contracts, \$8,000—total \$269,000! This is not to mention the bankrupt's equity in \$99,000 worth of inventory.

Contrary to the Court's decision that it was "an inescapable conclusion that the bankrupt was insolvent at the time of the transfer" (T.R. 45), the evidence fails to provide good reason to assume that there had been no substantial change in the status of the business with respect to assets and liabilities between the date of transfer and the date of filing the petition. (1 Collier, *Bankruptcy*, 1.19 [3]-[5], p. 125.)

It is most significant that plaintiff was compelled to rely on the theory of retrojection to establish insolvency because Mahl had fortuitously destroyed the books and records of the corporation after this suit was filed but before trial. (R.T. 18.) Under these circumstances, any doubt on this point should certainly be resolved in favor of defendant.

C. Reasonable Cause to Believe Insolvency.

In support of the argument that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the

erucial date, plaintiff sets forth seven facts concerning which Mr. Snider was purportedly aware on the date of transfer. (Appl's Br., p. 9.) Upon analysis, these seven facts are but two. Most of the matters cited relate to the bankrupt's inability to meet current obligations ("Facts" Nos. 1, 2, 3 and 5), and it is conceded that Mr. Snider was aware of this. As to the alleged "cessation" of payment of rent, ("Fact" No. 4) the evidence does not support the contention. It is true that the bankrupt was chronically late in paying rent; indeed, in October it had been nineteen days late and in April twenty-three days late. (R.T. 113.) At the date of transfer only eleven days had passed since the last rent payment had been made on October 19th. This is but another example of slow payment of which Mr. Snider was already aware.

The fact that the bankrupt was unable to meet current obligations due to a poor cash position and was therefore required to sell an asset which was not in use in the conduct of its business ("Fact" No. 6), is entirely consistent with solvency.

Merely because Mr. Snider had knowledge that the bankrupt was slow in meeting its current obligations does not support a finding that the transferee had reasonable cause to believe that the bankrupt was insolvent at the time of the transfer. (Appt's Op.Br., p. 13.)

Plaintiff finally argues ("Fact" No. 7) that Mr. Snider had been informed that Mahl Associates was insolvent and therefore had actual knowledge of the fact of insolvency. Major reliance is placed on disputed evidence on this point, which was rejected by the trial court, in attempting to establish reasonable cause to believe that insolvency existed: once in listing the seven alleged facts giving rise to reasonable cause to believe in insolvency (Appl's Br.,

p. 9); again in discussing *I-T-E Circuit Breaker Company* v. Holzman (9th Cir. 1965) 354 F.2d 102 (Appl's Br. p. 10); and once again in distinguishing, without other comment, cases cited in the opening brief on this subject (Appl's Br. p. 11).

The controversial and impeached testimony by Mahl and French on that subject (Appt's Br., p. 18) was unacceptable to and disregarded by the trial court. Plaintiff concedes as much (Appl's Br., p. 8.), and the trial court did not include as a finding of fact that Mr. Snider had actual knowledge of the bankrupt's insolvency.

It is obvious then that the two (actual knowledge and reasonable cause to believe) are completely distinct tests. Plaintiff, in effect, says that Mr. Snider had reasonable cause to believe insolvency existed because he had actual knowledge of that fact, even though the trial court refused to base its decision on that fact. It must be concluded that the trial court's finding that there was reasonable cause to believe in insolvency was based on facts other than the alleged conversation in October with Mr. Snider.

Without proof of actual knowledge of insolvency plaintiff's argument on this vital question must fail. All that is left is knowledge of the slowness of the bankrupt in making payments which is manifestly not sufficient.

Plaintiff's reference to the *I-T-E Circuit Breaker* case and his attempt to distinguish defendant's cited cases are therefore unavailing. The present case has less evidence of reasonable cause to believe than the *I-T-E Circuit Breaker* case since in effect only the third element attributed by plaintiff to that case is present here, i.e., that "the transferee knew that the bankrupt was consistently delinquent in meeting its bills from the transferee." (Appl's Br., p. 10.) From the foregoing it is clear that plaintiff has

offered no basis to refute defendant's assertion that the decision of the trial court was "clearly erroneous" in finding that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the date of the transfer.

D. Exclusion of Evidence.

The rejected evidence tendered by defendant through the witnesses Holderly and Vedovie (see Appt's Op.Br., pp. 19-20) was objected to for a variety of reasons including the ground that these witnesses were not named in the pre-trial statement. (R.T. 101.) There are two reasons why the ruling was wrong.

First, the local rules of the District Court expressly permit the use of witnesses not named in the pre-trial statement if the purpose is impeachment. (Rule 4[11].) The evidence offered through these witnesses (Appt's Op. Br., pp. 19-20), would have directly impeached Mahl's testimony that he told "most everyone who was interested" that the corporation was insolvent during the latter part of 1961 (R.T. 41.)

Furthermore, the evidence would have impeached Mahl's testimony as to when he last made applications for financing. Mahl did not testify that he was trying to get financing "up to the time he went into bankruptey" as the lower court's comment suggests. (R.T. 104-105.) Rather it was Mr. French who made that statement in his deposition, which he contradicted at trial. (R.T. 61.) Mahl testified that he was attempting to receive financing as late as October or November of 1961 (R.T. 46); that in the last quarter he was not attempting to borrow (R.T. 85); and that as late as September and October he was attempting to get loans of money (R.T. 85). This evidence would have impeached Mahl's testimony in this regard, indicating that

he was applying for credit as late as November 15, 1961. (R.T. 104.)

But more important, the local rules do not exclude direct evidence from witnesses who are not listed in the pre-trial statements. Discretion as to admissability is vested under the rules with the trial court. Here, the lower court based its ruling on the ground that the evidence was "purely hearsay"—not on the ground that the rules excluded the evidence. (R.T. 105, 122.) The question, then, is whether the evidence was properly excluded as being hearsay. Based upon a recent decision of this Court (cited by the court below) the answer must be answered in the negative.

Under the holding of *I-T-E Circuit Breaker Company v. Holzman* (9th Cir. 1965) 354 F.2d 102 (T.R. 47; Appt's Op.Br., p. 19; Appl's Br., p. 10) Mr. Snider was chargeable with notice of all facts which a reasonably diligent inquiry by himself would have disclosed. In the present case the trial court in effect said that a reasonably diligent inquiry by Mr. Snider would have revealed the alleged insolvency. The evidence barred related directly to this question. It was not offered for the *truth* of the statements as to Mahl Associates' financial condition, but simply to show the *effect* it would have had upon one making inquiry. Such is not hearsay. Fed.R.Civ.P. 43(a), Witkin, California Evidence (2d ed. 1966), §§ 468, 470, and cases cited therein.

II.

CONCLUSION

The decision below was wrong and must be reversed.

Dated: December 30, 1966.

Respectfully submitted,

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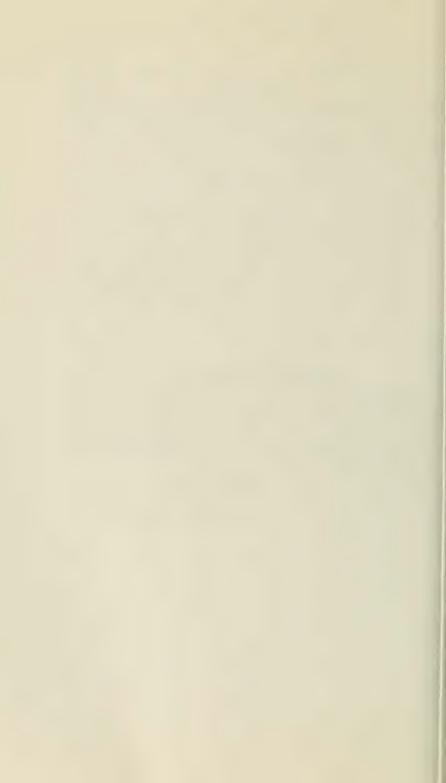
Attorneys for Appellant Archie Snider, individually and doing business as Snider Construction Co.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

John F. Taylor

Attorney for Appellant



No. 20982

United States Court of Appeals

FOR THE NINTH CIRCUIT

DAVID ERLICH,

Appellant.

vs.

JUDA GLASNER, CHAIM I. ETNER, BEZLIAL ORLANSKI, NEPTALI FRIEDMAN, OSHER ZILBERSTEIN; JUDA GLASNER, OSHER ZILBERSTEIN and CHAIM I. ETNER, doing business as the United Orthodox Rabbinate of Greater Los Angeles, United Orthodox Rabbinate of Greater Los Angeles, A. M. Bauman and Jacob Adler,

Appellees.

APPELLANT'S OPENING BRIEF.

FILED

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No. 20982

IN THE

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FOR THE NINTH CIRCUIT

DAVID ERLICH,

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JUDA GLASNER, CHAIM I. ETNER, BEZLIAL ORLANSKI, NEPTALI FRIEDMAN, OSHER ZILBERSTEIN; JUDA GLASNER, OSHER ZILBERSTEIN and CHAIM I. ETNER, doing business as the United Orthodox Rabbinate of Greater Los Angeles, United Orthodox Rabbinate of Greater Los Angeles, A. M. Bauman and Jacob Adler,

Appellees.

APPELLANT'S OPENING BRIEF.

Preliminary Statement.

This is an appeal by the plaintiff [Tr. p. 41] from a judgment dismissing his cause of action [Tr. p. 36]. This matter was before this court once before, also from a judgment entered on an order dismissing the cause of action because of failure to state a claim (*Erlich v. Glasner*, 9th Cir. 1965, 352 F. 2d 119).

Statement as to Jurisdiction.

This is an action under the Civil Rights Act (42 U.S.C.A. 1983, *et seq.*). Jurisdiction lies in the Federal Court pursuant to 28 U.S.C.A. 1343.

Statement as to the Facts.

The amended complaint in this cause was dismissed on defendants' motions for failing to state a claim [Tr. pp. 8, 15, 29]. The facts are all contained in the amended complaint [Tr. p. 2] and are the same as set forth in Appellant's Opening Brief in appeal 19872, and as stated in the opinion of *Erlich v. Glasner*, 9th Cir., 1965, 352 F. 2d 119, 120-121.

David Erlich is engaged in the process of slaughtering and processing kosher poultry, which he distributes wholesale and retail to the Jewish populace in Los Angeles and neighboring counties. For 13 years he operated as an individual under the fictitious name of West Coast Poultry Company [Complaint, Par. II, Tr. p. 3]. In August of 1960 he formed a corporation known as the West Coast Poultry Company which continued the same business at the same address. Plaintiff and his wife own all of the outstanding shares of stock in this corporation and the appellant is the president and general manager thereof. [Complaint, Par. III, Tr. p. 3].

The defendant Juda Glasner is a civil service employee employed by the Department of Health of the State of California as Kosher Food Law Representative charged with the enforcement of California Penal Code §383b. [Complaint, Par. V, Tr. p. 3]. He and the defendants Chaim I. Etner and Osher Zilberstein are also engaged in business under the fictitious name of United Orthodox Rabbinate of Greater Los Angeles [Complaint, Par. IV, Tr. p. 3]. Defendants Juda Glasner, Chaim Etner and Osher Zilberstein as alleged orthodox Rabbis contend that they, and only they, are empowered and have full and complete authority to dic-

tate what is and what is not kosher. [Complaint, Par. VI, Tr. p. 3]. Thus they have created themselves as the sole hierarchy to supervise kashruth. To enforce their dictatorship and compel the kosher poultry dealers of Southern California to retain their rabbinical services, the defendants use the police enforcement position of defendant Glasner, California Kosher Food Law Representative, and with threats of criminal prosecution coerce the poultry dealers of Southern California to retain their rabbinical services [Complaint, Par. VII, Tr. p. 4].

To compel the plaintiff in this cause to retain the rabbinical services of the United Orthodox Rabbinate of Greater Los Angeles, the defendant Juda Glasner in his capacity as Kosher Food Law Representative but not within his duties as kosher food law representative, filed two criminal complaints against the plaintiff, falsely accusing him of violating California Penal Code §383b [Complaint, Par. VIII (b); Tr. p. 4].

In the second criminal complaint in which the defendant Glasner was the complaining witness, Sam Salter and John Reyna, former employees of the plaintiff were offered payment to falsely testify under oath that the plaintiff was not slaughtering chickens pursuant to orthodox Hebrew religious requirements [Complaint, Par. VIII (d); Tr. p. 4].

When prosecution of the plaintiff under California Penal Code §383b was unsuccessful, the defendants pursuant to their conspiracy to compel plaintiff to retain the rabbinical services of the defendant, United Orthodox Rabbinate of Greater Los Angeles, again with Glasner as the complaining witness, but not within his duties as kosher food law representative, filed a series

of criminal complaints against Sidney Abramovitz, David Glickman, Bezlial Orlanski and Neptali Friedman, employees of the plaintiff, falsely charging them with violating California Penal Code §383b, so that they left the employ of the plaintiff [Complaint, Par. VIII (d) to (h); Tr. pp. 4-5].

Still in pursuance of their policy of coercion, the defendants communicated with the customers of the plaintiff and warned them that if they purchased kosher poultry from the plaintiff they would be charged by the defendant Glasner with a violation of California Penal Code §383(b) [Complaint, Par. VIII (a); Tr. p. 4], and to show that they meant business, the defendants in conformance with their conspiracy, entered into a champertous agreement with competitors of the plaintiff, who commenced an action in the Superior Court of the State of California, being L. A. Superior Court action No. 825,740 for an injunction to restrain plaintiff from selling poultry unless it was done under the supervision of these defendants [Complaint, Par. VIII (i); Tr. p. 5]. Furthermore, by means of advertising, these defendants cautioned the public of Southern California not to purchase any of plaintiff's kosher products [Complaint, Par. VIII (b), Tr. p. 4].

Following the reversal of the former appeal, a hearing was had on the spreading of the mandate at which particular time the trial court suggested that plaintiff amend Paragraphs VII and VIII of his complaint by alleging that the conduct of the defendant Glasner was not within the course of his duties. The trial court stated, that without deciding any of the issues in the cause, it was of the opinion that no right could exist against any of the defendants if Glasner was merely performing his duties.

Thereupon an amended complaint was filed in which it was alleged in paragraphs VII and VIII that the conduct of the defendant Glasner was: "not within the course of his duties as Kosher Food Law representative." [Tr. p. 4]. Plaintiff further amended his complaint by adding to paragraph IX, allegations that the interference by the defendants with the business of the West Coast Poultry Company was a direct interference with plaintiff's right to peacefully operate his business and earn a livelihood for himself and his family; all in violation of the privileges and immunities guaranteed to him as a citizen of the United States by Section 1 of Amendment XIV of the Constitution of the United States.

Plaintiff in his amended complaint added paragraph X requesting punitive damages [Tr. p. 6].

Following the service and filing of the amended complaint, the defendants again moved the court to dismiss the amended complaint and the action on the ground that the amended complaint failed to state a claim against the defendants upon which relief could be granted [Tr. pp. 8, 15 and 29]. The court granted the motion [Tr. p. 40] and entered a judgment of dismissal stating in substance as follows [Tr. pp. 35-37]:

- 1. That the Real Party in Interest was not the plaintiff, but the corporation West Coast Poultry Company which would suffer the damages alleged in the amended complaint and that a corporation has no cause of action under the Civil Rights Law.
- 2. That all of the acts alleged to have been committed by the defendant Glasner were:
- a. Committed by him with the course and scope of his employment as a duly qualified, appointed and act-

ing official of the Department of Health of the State of California being a kosher food law inspector thereof,

- b. that the acts charged by him in the amended complaint were discretionary acts, and
- c. He is protected from suit by immunity by the laws of the State of California.
- 3. That the allegations contained in paragraph VIII of the amended complaint to the effect that defendants entered into an unlawful combination and conspiracy for the purpose of depriving the plaintiff of the privileges and immunities guaranteed to him as a citizen of the United States by Section 1 of the 14th Amendment were mere conclusions of law unsupported by any proper and sufficient allegations of fact in the amended complaint.

The appeal from this judgment thereupon followed.

Questions for the Court.

The only question before this court is:

Does the amended complaint state facts sufficient to constitute a claim; or if defective, can it be amended to state one, for if the amended complaint can be further amended it is error to enter a judgment of dismissal without first giving the plaintiff the opportunity to mend.

APPELLANT'S ARGUMENT.

The appellant contends on this appeal as follows:

- 1. a. That the immunity laws of a state do not protect a public official (Judges, Prosecutors and Legislators excepted) from an action in the federal court for violation of the Civil Rights law.
- b. That in an action under the Civil Rights Act it would make no difference whether the public official (Judges, Legislators and Prosecutors excepted) was or was not acting within the scope of his duties; and it would make no difference whether the public official's acts were discretionary or ministerial.
- 2. That plaintiff's right to earn a livelihood for himself and his family and his right to hold property are privileges and immunities guaranteed to him by Section 1, Article XIV of the United States Constitution. If the defendants under color of law violated these guarantees of plaintiff, it would make no difference whether it was done to him directly or through a corporation wholly owned by himself and his wife.
- 3. a. That the allegations of an unlawful combination and conspiracy set forth in paragraph VIII of the amended complaint, subdivisions (a) through (i) inclusive contain sufficient allegations of facts of overt acts [Tr. pp. 4-5] to establish the unlawful combination and conspiracy.
- b. Pleading conclusions of law is not grounds for dismissing a pleading without leave to amend.

POINT I.

Regarding the Question of Immunity.

It is now well established that a public official (Judges, Prosecutors and Legislators excepted) have no immunity under the state law in an action brought under the Civil Rights Act. The leading case on this point is *Monroe v. Pape* (1961), 365 U.S. 167 (81 S. Ct. 473, 5 L. Ed. 2d 492).)

In Cohen v. Norris (9th Cir., 1962), 300 F. 2d 24, the same defense of immunity was also interposed. In rejecting this contention on the basis of Monroe v. Pape the Court stated on page 33:

"Monroe v. Pape involved police officers and, while the opinion of the court does not specifically discuss immunity, the result reached necessarily implies rejection of such a defense as a general proposition. As appellees concede, they would not be immune from liability had an action been brought against them in the courts of California for false arrest and imprisonment. See Miller v. Glass, 44 Cal. 2d 359, 282 P. 2d 501. But, in any event, no local rule of immunity unassociated wih a generally recognized common-law immunity can stand as a defense in a Civil Rights Acts case."

Probably the best expression that state immunity is not applicable to a violation of the Civil Rights Law is contained in *Nelson v. Knox* (U.S.C.A. 6th, 1958), 256 F. 2d 312, 314:

"We hold at the outset that the extent of the defendant's insulation from liability under the Civil Rights Act cannot properly be determined by reference to the local rule in Michigan. Surely each state cannot be left to decide for itself which of its officials are completely immune from liability for depriving a citizen of rights granted by the federal constitution. The question must be decided as a matter of general law."

Moreover, the defense of immunity from prosecution heretofore available to Judges, Prosecutors and Legislators (Agnew v. Moody (9th Cir., 1964), 330 F. 2d 868), is no longer applicable as a defense when the offender acts in some capacity other than in the position which grants him the immunity. Such a situation presented itself in Robichaud v. Ronan (9th Cir. 1965), 351 F. 2d 533, where the plaintiff brought an action under the Civil Rights Act against the county attorney and the deputy county attorney from Maricopa County, Arizona. The defendants pleaded that they were immune from liability for acts committed in the performance of their official duties, and the trial court dismissed the complaint. In reversing, the appellate court stated on page 536:

"We believe, however, that when a prosecuting attorney acts in some capacity other than his quasijudicial capacity, then the reason for his immunity—integral relationship between his acts and the judicial process—ceases to exist. If he acts in the role of a policeman, then why should he not be liable, as is the policeman, if, in so acting, he has deprived the plaintiff of rights, privileges, or immunities secured by the Federal Constitution and Laws? (citations.) To us, it seems neither appropriate nor justifiable that, for the same act, immunity should protect the one and not the other."

And the Court further stated on pages 537-538:

"The title of office, quasi-judicial or even judicial, does not, of itself, immunize the officer from responsibility for unlawful acts which cannot be said to constitute an integral part of judicial process."

Defendant Glasner in arguing immunity relies upon Hoffman v. Halden (9th Cir., 1959), 268 F. 2d 280 [Tr. pp. 31-32]. However, Cohen v. Norris, supra, expressly overruled Hoffman v. Halden and held that in view of Monroe v. Pape, police officers even in the exercise of discretionary functions are liable in an action under the Civil Rights law (Cohen v. Norris, supra, on pages 29-20).

It is therefore respectfully submitted that as a matter of law, the doctrine of immunity as a defense is not applicable to this cause.

POINT II.

Regarding the Deprivation of Plaintiff's Constitutional Rights Under the Fourteenth Amendment.

In entering judgment for the defendants the court determined that the real party in interest was not the plaintiff but the West Coast Poultry Company, a California corporation; and that from the allegations in the amended complaint it was the corporation, that suffered injuries and not the plaintiff, and that a corporation has no cause of action under 42 U.S.C.A. 1983, or any other federal statute for alleged violation of its Civil Rights [Tr. pp. 35-36].

It is respectfully submitted that this conclusion is error for three reasons:

- a. That since Erlich is a dominant shareholder in the corporation, an attack upon the corporation is an injury to plaintiff's property consisting of his ownership of shares in the corporation.
- b. Under the privileges and immunities section of Section 1, Article XIV of the United States Constitution, Erlich is guaranteed this right to pursue a lawful occupation and earn a living for himself and his family.
- c. That several of the overt acts alleged in paragraph VIII of the amended complaint, are directed against the plaintiff personally, and not against the corporation [Tr. p. 5].
- A. Regarding the Injury to the Plaintiff as a Shareholder of West Coast Poultry Company, a California Corporation.

While it is true that Section 1983 permits relief only to natural persons because only natural persons and not artificial persons are citizens of the United States entitled to the privileges and immunities under Section 1 of the XIV Amendment (*Hague v. C.I.O.* (1939), 307 U.S. 496, 514, 59 S. Ct. 954, 83 L. Ed. 1423), nevertheless "a corporation is a 'person' within the meaning of the due process and equal protection clauses of the Fourteenth Amendment. . . ." (*Louis K. Liggett Co. v. Baldrige* (1928), 278 U.S. 105, 111 [49 S. Ct. 57, 58, 73 L. Ed. 204]).

A person's business, whether corporate or individual is also a property right (Louis K. Liggett Co. v. Baldridge, supra.)

In California shares of stock are personal property (Kirkland v. Levin (1923), 63 Cal. App. 589, 590 [219 Pac. 455]), and although the owner of shares is not the owner of the corporate assets, he has a right to share in the corporate earnings and assets after dissolution (Rhode Island Hospital Trust Co. v. Doughton (1925), 270 U.S. 69, 81 [46 S. Ct. 256, 258] 70 L. Ed. 475). Since the value of shares is determined by the corporation's assets and earnings, any impairment of the corporation's property or its earning power reduces the value of the stock and proportionally diminishes the value of the shareholder's property (Burke v. Badlam (1881), 57 Cal. 594, 601).

Plaintiff and his wife own all of the outstanding shares of stock in West Coast Poultry Company [Amended Complaint, par. III, Tr. p. 33]. The conduct of the defendants as alleged in the amended complaint was in violation of the privileges and immunities of the plaintiff to own property as guaranteed to him by Section 1, Article XIV, of the United States Constitution.

Moreover, a cause of action may exist in favor of both the corporation and the stockholder.

In Sutter v. General Petroleum Corp. (1946), 28 Cal. 2d 525, 170 P. 2d 898, plaintiff commenced an action for fraud. The plaintiff contended that by fraudulent representations and promises he was induced to participate in the organization and financing of a corporation. The trial court dismissed the cause of action on the grounds that the injuries complained of were done to the corporation and not the plaintiff as a shareholder and that since the cause of action was not derivative or representative in which the shareholders would sue

in behalf of the corporation, no cause of action was stated.

In reversing the Supreme Court of the State of California said as follows on page 530:

"Generally a stockholder may not maintain an action in his own behalf for a wrong done by a third person to the corporation on the theory that such wrong devalued his stock and the stock of the other shareholders, for such an action would authorize multitudinous litigation and ignore the corporate entity. Under proper circumstances a stockholder may bring a representative action or derivative action on behalf of the corporation. (citations.) But 'If the injury is one to the plaintiff as a stockholder and to him individually and not to the corporation, as where the action is based on a contract to which he is a party, or on a right belonging severally to him, or on a fraud affecting him directly, it is an individual action. . . . The action is derivative, i.e., in the corporate right, if the gravamen of the complaint is injury to the corporation, or to the whole body of its stock or property without any severance or distribution among individual holders, or if it seeks to recover assets for the corporation or to prevent the dissipation of its assets.' (citations.) And a stockholder may sue as an individual where he is directly and individually injured although the corporation may also have a cause of action for the same wrong. (Citations.)"

And again on page 531:

"In that fashion the defect in the island and the failure to perform the promises injured the Devel-

opment Company and Rincon Company but there was also a direct individual injury to plaintiff Sutter, and, as we have seen, the dual nature of the injury does not necessarily preclude an action by the stockholder as an individual. Defendants, by their promises and representations induced plaintiff to form the corporation and invest his money therein, and then breached their duty of honest dealing with him. By way of damages plaintiff Sutter asserts that because of the false representations he invested \$33,440 in the venture and the Rincon Company, and that as the result of the fraud of defendants the stock in the Rincon Company became valueless.

"While ordinarily a stockholder may not sue individually for impairment of a corporation's assets rendering the stock worthless, yet here that result is merely one method of ascertaining the amount of damages suffered by Sutter. He lost his investment which was represented by the stock, and its reduction in value would be the extent of his loss. The damages all flowed from the tort of the defendants."

B. The Interference by the Defendants With the Plaintiff's Right to Earn a Living for Himself and His Family Is a Violation of Plaintiff's Rights Under the Fourteenth Amendment.

The right to earn a living is a property right guaranteed to the plaintiff under the due process clause of the Fifth Amendment to the Federal Constitution (De Mille v. American Federation of Radio Artists (1947), 31 Cal. 2d 139, 153 [187 P. 2d 769]; Van Zandt v. McKee (5th Cir., 1953), 202 Fed. Rep. 2d 490, 491)

and also under the due process clause of the Fourteenth Amendment to the Federal Constitution (*Truax v. Corrigan* (1921), 257 U.S. 312, 327 [42 S. Ct. 124, 127; 66 L. Ed. 54]; *Wallace v. Ford* [D. C. Texas, 1937], 21 F. Supp. 624, 628).

Truax v. Corrigan, supra, involved the question of a right to picket. The court stated on page 327:

"Plaintiff's business is a property right (citation), and free access for employees, owner, and customers to his place of business is incident to such right. Intentional injury caused to either or both by a conspiracy is a tort. Concert of action is a conspiracy, if its object is unlawful or if the means used are unlawful."

It is undisputed that the defendants and each of them are interfering with the plaintiff's right to earn a living by attempting to compel him to join and operate his business only pursuant to their rabbinical organization. It is also undisputed that the defendant Glasner, the Kosher Food Law Representative, is using his official position as an employee of the State of California, under color of law, to coerce plaintiff to join. Unquestionably the defendants were operating under color of law. There is no difference between the facts stated in Monroe v. Pape (1961), 365 U.S. 167 [81 S. Ct. 473. 5 L. Ed. 2d 492] where police officers of the City of Chicago broke into the petitioners home in the early morning, got them out of bed, made them stand naked in the living room, opening drawers, ripping mattress covers, and then taking them to the police station and detaining them on open charges for about 10 hours with the facts in the present cause that the defendant Glasner pursuant to the conspiracy filed unmeritorious

complaints, charging the plaintiff with the violation of California Penal Code §383b; and in the second complaint attempted to compensate two former employees of the plaintiff to testify falsely as to alleged transgression. If there is a difference, it can only be one of degree.

In selling his product to the public as kosher, Erlich is only required to exercise his judgment in good faith that the product is in fact kosher (*Hygrade Provision Co. v. Sherman* (1925), 266 U.S. 497 [45 S. Ct. 141] 69 L. Ed. 402; *Erlich v. Municipal Court* (1961), 55 Cal. 2d 553, 11 Cal. Rptr. 758, 360 P. 2d 334).

The defendants should not be permitted to compel plaintiff to do more. Their persistence in so doing is a direct violation of the Hobbs Act (18 U.S.C.A. 1951) the essential elements of which are interference with commerce and extortion (*Stirone v. United States* (1960), 361 U.S. 212, 218 [80 S. Ct. 270, 274; 4 L. Ed. 2d 252]). It is also in violation of plaintiff's guaranteed civil rights (18 U.S.C.A. 241).

In Carbo v. United States (9th Cir., 1963), 314 F. 2d 718, 732, it is stated:

"Under the Hobbs Act (as distinguished from the Sherman Act) it is not necessary that the subject of the extortion constitute commerce. All that is required is that trade or commerce be affected by extortion 'in any way or degree.'"

In Robinson v. Lull (U.S.D.C. III. 1956), 145 Fed. Supp. 134, 138, the Court quoted from Doremus v. Hennessy (1898), 176 III. 608, 614, 52 N.E. 924, 925, 54 N.E. 524, 43 L.R.A. 797 as follows:

"'No persons, individually or by combination, have the right to directly or indirectly interfere or

disturb another in his lawful business or occupation, or to threaten to do so, for the sake of compelling him to do some act which, in his judgment, his own interest does not require."

It is also basic that plaintiff's right to work is included in the concept of liberty within the meaning of the 14th amendment of the Federal Constitution; and when that right is violated the courts will not hesitate to intervene and undo the mischief (*Parker v. Lester* [9th Cir. 1955], 227 F. 2d 708, 713-714).

Dent. v. State of West Virginia (1889), 129 U.S. 114 [9 S. Ct. 231], 32 L. Ed. 623, involved the validity of a state statute requiring that a practitioner of medicine obtain a certificate from the State Board of Health that he is a graduate of a reputable medical college in the School of Medicine to which he belongs; or that he has practiced medicine in the state continuously for the period of 10 years prior to March 8, 1881. In discussing the rights of individuals to pursue their vocation, it was stated by Mr. Justice Field on page 121:

"It is undoubtedly the right of every citizen of the United States to follow any lawful calling, business, or profession he may choose, subject only to such restrictions as are imposed upon all persons of like age, sex and condition. This right may in many respects be considered as a distinguishing feature of our republic institutions. Here all vocations are open to everyone on like conditions. All may be pursued as sources of livelihood, some requiring years of study and great learning for their successful prosecution. The interest, or, as it is sometimes termed, the 'estate' acquired in them—that is, the right to continue their prosecution,—is often of great value to the possessors, and cannot be arbitrarily taken from them, any more than the real or personal property can be thus taken."

Truax v. Raich (1915), 239 U.S. 33 [36 S. Ct. 7, 60 L. Ed. 131], involved the question whether the State of Arizona could limit the employment of aliens. Mr. Justice Hughes in delivering the opinion of the Court stated in regard to the question of the right to work on page 38:

"The right to earn a livelihood and to continue in employment unmolested by efforts to enforce void enactments should similarly be entitled to protection in the absence of adequate remedy at law."

and again on page 41:

"It requires no argument to show that the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was a purpose of the Amendment [Fourteenth Amendment] to secure. (Citations.) If this could be refused solely on the ground of race or nationality, the prohibition of the denial to any person of the equal protection of the laws would be a barren form of words."

In Meyer v. State of Nebraska (1923), 262 U.S. 390, [43 S. Ct. 625, 67 L. Ed. 1042], the appellant was convicted under an information which charged him with unlawfully teaching the subject of reading in the German language to a child under 10 years of age who had not attained and successfully passed the 8th grade.

In reversing and discussing the rights and freedom under the Fourteenth Amendment:

"No state . . . shall deprive any person of life, liberty or property without due process of law",

Mr. Justice McReynolds in the opinion for the court stated on page 399:

"While this court has not attempted to define with exactness the liberty thus guaranteed, the term has received much consideration and some of the included things have been definitely stated. Without doubt, it denotes not merely freedom from bodily restraint but also the right of the individual to contract, to engage in any of the common occupations of life, to acquire a useful knowledge, to marry, establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized at common law as essential to the orderly pursuit of happiness by free men (citations)."

Terrace v. Thompson (1923), 263 U.S. 197, 44 S. Ct. 15, 68 L. Ed. 255, although affirming the alien property laws then in existence, also stated that the Fourteenth Amendment protected an alien of Japanese descent in his right to earn a livelihood by following the ordinary occupations of life, relying upon Truax v. Raich and Meyer v. State of Nebraska.

And in *Greene v. McElroy*, 360 U.S. 474, 492, 79 S. Ct. 1400, 3 L. Ed. 2d 1377, it was again iterated that the right to hold specific private employment and follow a chosen profession free from unreasonable governmental interference comes within the liberty and property concept of the Fifth Amendment.

The allegations of unlawful conduct on the part of the defendants is a direct interference with plaintiff's right to earn a livelihood for himself and his family as guaranteed to him by the privileges and immunities portion of the Fourteenth Amendment. The fact that this is done to a corporation owned and controlled by him and through which he earns his livelihood, rather than to him directly, is of no matter. Language to that effect appears in *Royal News Company v. Schultz* (U.S.D.C., Michigan, 1964), 230 F. Supp. 641, 643 where plaintiff sought an injunction under the Civil Rights Act. (Injunction modified, *Royal News v. Schultz*, 6th Cir., 1965), 350 F. 2d 302.)

"Since the effect of such seizures and criminal prosecutions would be to deprive the plaintiff of business and its employees and agents of livelihood in contravention of their constitutionally protected rights, the court indicated during that hearing that it was inclined to issue an injunction to prevent the abuse of these rights."

C. Regarding the Allegations in the Amended Complaint.

Moreover, it should not be overlooked that the amended complaint contains many allegations of overt acts of injuries done directly to the plaintiff, rather than through his corporation. For example, paragraph VIII of the amended complaint alleges that the defendants communicated with the customers of the plaintiff [Amended Complaint, Par. VIII(a), Tr. p. 4], and Paragraph VIII(c) [Tr. p. 4] alleges that the criminal complaints were filed against the plaintiff and not against the corporation (*Erlich v. Municipal Court* (1961,) 55 Cal. 2d 553, 11 Cal. Rptr. 758, 360 P. 2d 334).

Since in a motion to dismiss for failure to state a claim all of the allegations contained in the complaint are taken as true (*Cooper v. Pate* (1964), 378 U.S. 546 (84 S. Ct. 1733, 12 L. Ed. 2d 1030), it was of course error for the trial court to determine as a matter of law that these allegations were not correct and that the injury was done to the corporation and not to the plaintiff directly.

POINT III.

Regarding Pleading Conclusions of Law in the Amended Complaint.

The trial court held that the allegations of unlawful combination and conspiracy alleged in Paragraph VIII of the amended complaint were conclusions of law unsupported by any proper and sufficient allegations of fact [Tr. p. 36].

The essential elements required in a complaint brought under the Civil Rights Act are set forth in *Lucero v. Donovan* (9th Cir., 1965), 354 F. 2d 16, where the court stated on pages 19-20:

"Generally expressed, 'The only elements which need to be present in order to establish a claim for damages under the Civil Rights Act are that the conduct complained of was engaged in under color of state law, and that such conduct subjected the plaintiff to the deprivation of rights, privileges or immunities secured by the Constitution of the United States' (citation.) Here, it cannot be denied that defendants were acting under 'color of state law.' The issue is whether there was 'deprivation of rights, privileges or immunities, secured by the Constitution (or laws) of the United States.'"

It is respectfully submitted that Paragraph VIII of the amended complaint contains all these elements [Tr. pp. 4-6]. Alleged in Paragraph VIII are 9 overt acts committed by the defendants to injure the plaintiff. This is sufficient to advise defendants of the nature of plaintiff's claim and if they seek particulars the means is by way of discovery. But as it stands, plaintiff's amended complaint spells out a good cause of action for violation of the Federal Civil Rights Act.

In any event, pleading conclusions of law is insufficient reason to dismiss the amended complaint without leave to amend (*Conly v. Gibson* (1957), 355 U.S. 41, 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80).

POINT IV.

Conclusion.

For all of the above reasons the judgment should be reversed and the cause remanded to the District Court with instructions to overrule the motion to dismiss and give defendants an opportunity to answer.

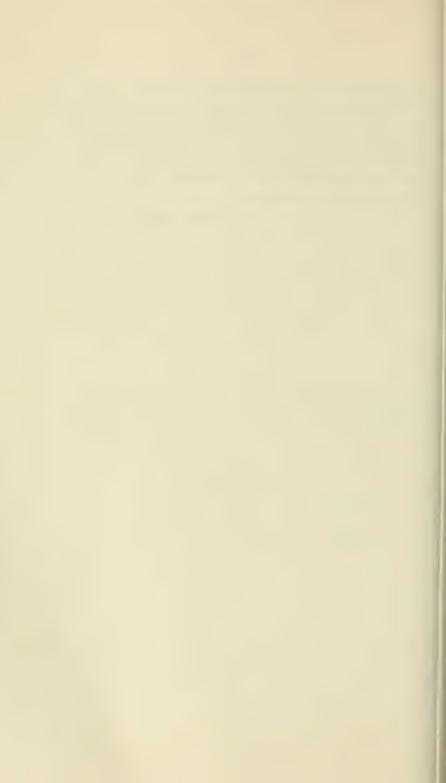
Respectfully submitted,

Joseph W. Fairfield and Ethelyn F. Black, Attorneys for Appellant.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JOSEPH W. FAIRFIELD.







APPENDIX.

The pertinent portions of the statutes referred to in Appellant's Opening Brief are as follows:

Item 1. (Page 1) United States Code Annotated, Title 42 §1983:

"Civil action for deprivation of rights.

"Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress."

Item 2. (Page 1) United States Code Annotated, Title 28, §1343, subds. 1, 2, 3 and 4:

"§1343. Civil rights and elective franchise

The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person:

- (1) To recover damages for injury to his person or property, or because of the deprivation of any right or privilege of a citizen of the United States, by any act done in furtherance of any conspiracy mentioned in section 1985 of Title 42;
- (2) To recover damages from any person who fails to prevent or to aid in preventing any wrongs mentioned in section 1985 of Title 42 which he had knowledge were about to occur and power to prevent;

- (3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any right, privilege or immunity secured by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States;
- (4) To recover damages or to secure equitable or other relief under any Act of Congress providing for the protection of civil rights."
- Item 3. (Pages 2, 4, 16) California Penal Code §383b. (Note, Penal Code §383 referred to on page 17 should be section 383b.)

"§383b. Kosher meats and meat preparations; sale and labeling regulations; false representations; punishment; kosher defined.

Every person who with intent to defraud, sells or exposes for sale any meat or meat preparations, and falsely represents the same to be kosher, whether such meat or meat preparations be raw or prepared for human consumption, or as having been prepared under and from a product or products sanctioned by the orthodox Hebrew religious requirements; or falsely represents any food product, or the contents of any package or container, to be so constituted and prepared, by having or permitting to be inscribed thereon the words 'kosher' in any language; or sells or exposes for sale in the same place of business both kosher and nonkosher meat or meat preparations, either raw or prepared for human consumption, who fails to indicate on his window signs in all display advertising in block

letters at least four inches in height 'kosher and nonkosher meats sold here'; or who exposes for sale in any show window or place of business as both kosher and nonkosher meat preparations, either raw or prepared for human consumption, who fails to display over each kind of meat or meat preparation so exposed a sign in block letters at least four inches in height, reading 'kosher meat' or 'nonkosher meat' as the case may be; or sells or exposes for sale in any restaurant or any other place where food products are sold for consumption on the premises, any article of food or food preparations and falsely represents the same to be kosher, or as having been prepared in accordance with the orthodox Hebrew religious requirements; or sells or exposes for sale in such restaurant, or such other place, both kosher and nonkosher food or food preparations for consumption on the premises, not prepared in accordance with the Jewish ritual, or not sanctioned by the Hebrew orthodox religious requirements, and who fails to display on his window signs in all display advertising, in block letters at least four inches in height 'kosher and nonkosher food served here' is guilty of a misdemeanor and upon conviction thereof be punishable by a fine of not less than fifty dollars, nor more than three hundred dollars, or imprisonment in the county jail of not less than thirty days, nor more than ninety days, or both such fine and imprisonment.

The word 'kosher' is here defined to mean a strict compliance with every Jewish law and custom pertaining and relating to the killing of the animal or fowl from which the meat is taken or extracted, the dressing, treatment and preparation thereof for human consumption, and the manufacture, production, treatment and preparation of such other food or foods in connection wherewith Jewish laws and customs obtain and to the use of tools, implements, vessels, utensils, dishes and containers that are used in connection with the killing of such animals and fowls and the dressing, preparation, production, manufacture and treatment of such meats and other products, foods and food stuffs. (Added Stats. 1931, c. 1029, p. 2147, §1.)"

Item 4. (Page 14) United States Constitution, Fifth Amendment:

"No person shall . . ., nor be deprived of life, liberty, or property, without due process of law; . . ."

Item 5. (Pages 5, 6, 7, 11, 12) United States Constitution, Fourteenth Amendment, §1.

"No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Item 6. (Page 16) United States Code Annotated, Title 18, §241:

Conspiracy against rights of citizens

"If two or more persons conspire to injure, oppress, threaten, or intimidate any citizen in the free exercise and enjoyment of any right or privilege secured to him by the Constitution or laws of the United States, or because of his having so exercised the same; . . .

"They shall be fined . . ."

Item 7. (Page 16) United States Code Annotated, Title 18, §1951:

Interference with commerce by threats or violence

"Whoever in any way or degree obstructs, delays, or affects commerce or the movement of any article or commodity in commerce, by robbery or extortion or attempts or conspires so to do, . . .

- (2) The term 'extortion' means the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence or fear, or under color of official right.
- (3) The term 'commerce' means . . . all commerce between any point in a State . . . and any point outside thereof; all commerce between points within the same State through any place outside such State; and all other commerce over which the United States has jurisdiction."

Item 8. (Page) United States Code Annotated, Title 42, § 1985(3):

"Conspiracy to Interfere with civil rights

Depriving of rights or privileges

(3) If two or more persons in any State or Territory conspire or go in disguise on the highway or on the premises of another, for the purpose of depriving, either directly or indirectly, any person or class of persons of the equal protection of the laws, or of equal privileges and immunities under the

laws; . . . in any case of conspiracy set forth in this section, if one or more persons engaged therein do, or cause to be done, any act in furtherance of the object of such conspiracy, whereby another is injured in his person or property, or deprived of having and exercising any right or privilege of a citizens of the United States, the party so injured or deprived may have an action for the recovery of damages, occasioned by such injury or deprivation, against any one or more of the conspirators."

No. 20982 IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DAVID ERLICH,

Appellant,

US.

JUDA GLASNER, et al.,

Appellees.

On Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLEE, JUDA GLASNER.

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DAVID ERLICH,

Appellant,

US.

JUDA GLASNER, et al.,

Appellees.

On Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR APPELLEE, JUDA GLASNER.

INTRODUCTORY.

Plaintiff, David Erlich, appeals from the judgment dismissing the action brought by him as an individual against several defendants, including appellee, Juda Glasner. This brief is on behalf of appellee Glasner.

A prior dismissal was reversed because the trial court had stated no specific reason for dismissal and with the suggestion that amendment of appellant's complaint might be sought. (*Erlich v. Glasner*, 9 Cir., 1965, 352 F. 2d 119, 122-123.) Appellant filed an amended complaint. [Tr. pp. 2 et seq.] The trial court, pursuant to motions of the respective defendants, rendered its judgment of dismissal in which three grounds or reasons were specified as hereafter noted [Tr. pp. 35-37] from which judgment plaintiff took this appeal. [Tr. p. 41.]

JURISDICTION AS CLAIMED BY APPEL-LANT IN THE DISTRICT COURT.

Appellant's pleading is entitled "Amended Complaint For Violation of Civil Rights (42 USCA 1983)". By paragraph I thereof, appellant alleged [Tr. p. 2] that the District Court "has jurisdiction of this cause pursuant to 28 USCA 1343(3) which provides for actions to redress the deprivation, under power of any law, statute, ordinance, regulation, custom or usage of any state, of any right, privilege or immunity secured by the Constitution of the United States; and pursuant to 28 U.S.C.A. Sec. 1331 which provides for actions arising under the Constitution of the United States", followed by allegation that the amount in controversy exceeds \$10,000.00. By paragraph IX of his amended pleading, appellant alleged [Tr. p. 6] that defendants' interference with the business of West Coast Poultry Company [a corporation—Tr. p. 3 "III"] is a direct interference with plaintiff's right to operate his business and earn a livelihood for himself and family and that defendants' acts "deprived plaintiff of his privileges and immunities, guaranteed to him as a citizen of the United States by Section 1 of Amendment 14 of the Constitution of the United States;" and proximately caused damage and injuries to "his right and ability to earn a livlihood [sic] for himself and family, all to plaintiff's damage in the sum of \$250,000.00."

The foregoing statutes and constitutional provision are those which appellant alleged as a basis for the jurisdiction of the District Court in this cause.

STATEMENT OF THE CASE.

Appellant is the sole plaintiff and his action was brought and is sought to be maintained by him solely as an individual.

Appellant evidently claims that he had been deprived of his *privileges and immunities* as a citizen of the United States guaranteed to him as such under the Constitution, Amendment 14, section 1. [Tr. p. 6, "IX", as heretofore stated.]

Appellant's claimed jurisdictional basis is as above noted. The remaining allegations of his amended pleading are as follows:

From November, 1947, to August, 1960, appellant was engaged in the business of slaughtering and dispensing poultry, kosher and non kosher, at a certain address in Santa Monica, California, under the fictitious firm name of West Coast Poultry Company. [Tr. p. 3, "II".]

In August, 1960, West Coast Poultry was organized as a California corporation. Appellant and his wife own all the stock of said corporation. Appellant is president and general manager of the corporation. It is a continuation of the poultry business of plaintiff at the same address. [Tr. p. 3, "III".]

Defendants Glasner, Etner and Zilberstein are "doing business" under the fictitious name of United Orthodox Rabbinate of Greater Los Angeles. [Tr. p. 3, "IV".]

Defendant Glasner is employed by the Department of Public Health of the State of California as the kosher food law representative and his duties consist of investigation of violations of the kosher food laws of the State of California pursuant to §383b of the California Penal Code. [Tr. p. 3, "V".] (Parenthetical note: See California Health and Safety Code, sec. 214, reading: "The State Department of Public Health shall enforce the provisions of Section 383b of the Penal Code.")

Defendants contend that they are Orthodox Rabbis and that only they should have control to "dictate" what is and what is not kosher. Defendants' "purposes" "is to prevent plaintiff and other kosher poultry dealers from using the services of any other rabbi except themselves" and to compel plaintiff and others to retain only defendants' services. [Tr. p. 3, "VI".]

To compel kosher poultry dealers in Los Angeles County to retain defendants' rabbinical services, defendant Glasner, "acting in his capacity as kosher food law inspector of the State of California, but not within the course of his duties as kosher food law representative", has caused issuance of criminal complaints charging violations of California Penal Code, §383b, to those dealers who do not use defendants' rabbinical services. [Tr. p. 4, "VII".]

On or about April 1, 1964, defendant Glasner, "while acting in his official capacity as kosher food law representative of the State of California, but not within his duties as kosher food law representative," and all defendants, acting under color of law, entered into an "unlawful" combination and conspiracy for the purpose of depriving plaintiff of his privileges and immunities guaranteed every "citizen" of the United

States by the Constitution, Amendment 14, section 1, and in pursuance thereof, have committed the following acts: (a) Communicated with customers of "plaintiff and West Coast Poultry Company, a California corporation," and advised them that if they purchased kosher products from plaintiff or said corporation citations would be issued against them by defendant Glasner for violating Penal Code §383b. (b) Circulated advertisements in newspapers advising the public not to purchase plaintiff's kosher products. (c) Filed two criminal complaints against plaintiff, "falsely accusing him of violating §383b of the Penal Code." (d) Filed criminal complaints against employees of plaintiff and West Coast Poultry Company, a corporation, "falsely charging them with violating" California laws to coerce these employees to leave said employment. (e) Charged one Abramovitz, who was employed as "schoichet" and West Coast Poultry Company in the Los Angeles Municipal Court with aiding and abetting poultry dealers with violating Penal Code §383b and in the Beverly Hills Municipal Court with violating Penal Code §240 and Health & Safety Code §26518.5, with the result that said Abramovitz left the employ of plaintiff rather than be a "constant defendant in criminal actions." (f) Filed a criminal complaint against one Glickman, "a schoichet employed by plaintiff and West Coast Poultry Company," charging him in the Los Angeles Municipal Court with aiding and abetting unidentified kosher butchers to violate Penal Code §383b and as a result Glickman left said employ (g) Offered payment to

Salter and Reyna, "former employees of the plaintiff," to appear as witnesses against plaintiff and falsely testify that he is not slaughtering chickens pursuant to orthodox Hebrew religion requirements. (h) Defendants Orlanski and Friedman were former employees of plaintiff; defendant Glasner caused to be issued in the Los Angeles Municipal Court a criminal complaint charging them with aiding and abetting kosher poultry dealers with violating California Penal Code §383b; "the remaining defendants" advised the defendants Orlanski and Friedman that if they would cooperate with them against plaintiff the criminal complaint would be dismissed. (i) Entered into a champertous agreement with three competitors of "plaintiff and West Coast Poultry Company" to commence an action against West Coast Poultry Company for an injunction to prevent that corporation from selling kosher poultry unless they retained defendants' rabbinical services; such action was commenced in the Los Angeles Superior Court, being action No. 825,740; said three competitors have no interest in said action and commneced it at defendants' request; said action is sponsored and financed by defendants. [Tr. pp. 4-6, "VIII".]

The interference by defendants "with the business of the West Coast Poultry Company is a direct interference with the right of the plaintiff to peacefully operate his business and earn a livlihood [sic] for himself and his family" and the defendants' acts "under color of law as hereinabove set out deprived the plaintiff of his privileges and immunities, guaranteed to him

as a citizen of the United States by Section 1 of Amendment 14 of the Constitution of the United States," and as a proximate result of the "overt acts hereinabove set forth, plaintiff has sustained damages and injuries to his business and right and ability to earn a livlihood [sic] for himself and his family, all to plaintiff's damage in the sum of \$250,000.00." [Tr. pp. 5-6, "IX".]

The conduct of defendants was "opprobrious, wilful and malicious" and plaintiff requests punitive damages of \$100,000.00. [Tr. p. 6, "X".]

These constitute the allegations of plaintiff's amended complaint.

Three separate motions to dismiss the action were filed, each being based on the ground of failure to state a claim against the particular movant or movants upon which relief could be granted. [Tr. p. 8, Glasner; p. 15, Etner; p. 29, Orlanski, Friedman, Zilberstein, Bauman, and United Orthodox Rabbinate of Greater Los Angeles.] The motion of Glasner was based on the notice, points and authorities in support thereof [Tr. pp. 10-12 and 31-33], and the pleadings, records and other documents in the cause. [Tr. p. 8, line 31, to p. 9, line 1.] Among the records and documents on file (attached as Exhibit A to Glasner's motion to dismiss the original complaint—9th Cir., case number 19872, Tr. p. 23) was a copy of the "California State Personnel Board Specification for Class of Kosher Food Representative", an official act of the Board made pursuant to California Government Code, section 18000,

and which is judicially noticed (Rule 43(a), Fed. Rules Civ. Proc.), thereby showing the duties attached to the position of Kosher Food Law Representative.¹ In

¹Thereunder, as Kosher Food Law Representative, appellee Glasner was invested with discretionary duties. Thus, in *Glickman v. Glasner* (1964), 230 Cal.App.2d 120, 40 Cal.Rptr. 719, after quoting from the "California State Personnel Board Specification for the Class of Kosher Food Law Representative" in footnote 2, it was held (230 Cal.App.2d at pp. 125-127, 40 Cal.Rptr. at pp. 723-724):

"The duties of the Kosher Food Law Representative were discretionary in nature. The trial judge, in her memorandum

opinion, stated:

"'(1) Defendant Glasner's qualification for his employment as Kosher Food Inspector cannot be attacked in this proceeding. The determination of the qualifications for public employment and the determination of discipline and dismissal of such personnel rests in the hands of the State Civil Service and Personnel Boards, not in the courts at the instance of private litigants. [Citations.]

"'(2) Defendant Glasner is completely immune from liability if his publication of Exhibit 1 were within the scope of his discretionary duties, regardless of his personal motivations, good or ill. (Lipman v. Brisbane Elem. School Dist., 55 Cal. 2d 224 [11 Cal.Rptr. 97, 359 P.2d 465] (1961); Hardy v. Vial, 48 Cal.2d 577 [311 P.2d 494, 66 A.L.R.2d

739] (1957).)

"'The duties of a Kosher Food Representative are stated by the State Personnel Board, set forth in defendants' affidavit, read with Penal Code Section 383b and with Health and Safety Code Section 214. Those duties specifically include advising interested persons "such as kosher meat and poultry packers, wholesalers, retailers, and restauranteurs on application of the State Kosher Food Law * * *." The Kosher Food Inspector also "conducts investigations, gathers, assembles, and reports facts and evidence." (Exhibit 1 to defendant Glasner's affidavit.)

"'These duties obviously involve the exercise of discretion. In carrying out the obligations of his office, the inspector must decide what facts he shall gather, which investigations will be made, and what reports in his reasoned judgment should be made to bring about compliance with Penal Code Section 383b. [Citations.]

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[&]quot;'The principle established by these cases may work hardship from time to time, but were the rule otherwise greater mischief would result . . .

Cooper v. O'Connor (D.C. Cir., 1938), 69 App. D.C. 100, 99 F.2d 135, 118 A.L.R. 1440, cert. den. 305 U.S. 642, 59 S.Ct. 146, 83 L.ed. 414, it was said (99 F.2d at p. 138), "we may properly take judicial notice of the official duties of each of the appellees and thus determine whether the acts charged in the declaration fell within the general scope of their authority." For convenience of the Court, the pertinent portions of said "California State Personnel Board Specification for Class of Kosher Food Law Representative" are quoted and set forth in the Appendix to this brief.

The motions were heard and argued February 28, 1966. [Tr. p. 40.] Judgment of dismissal was entered March 10, 1966, on the stated and specified grounds and reasons that [Tr. pp. 35-37]:

- 1. The real party in interest is not plaintiff individual but is West Coast Poultry Company, a corporation, which is shown by the amended complaint's allegations to be the one which would suffer damage if the allegations were true; and a corporation has no cause of action under 42 USC 1983 or any other Federal statute for alleged violation of its civil rights.
- 2. Appellee Glasner at all times material hereto was a duly qualified, appointed and acting official of the

[&]quot;'Taking the statutes, the office, and the duties as we find them, it is plain that this defendant is not exposed to liability in this case. Accordingly, the Court grants defendant Glasner's Motion for Summary Judgment. There is no triable issue of fact.'

[&]quot;We concur with the trial judge."

Petition for hearing by the California Supreme Court was denied on December 9, 1964.

California Department of Public Health, being Kosher Food Inspector; all acts charged to him in the amended complaint, if true, were committed by him in the course and scope of his employment in such official capacity; all acts charged to him by the amended complaint were discretionary acts; and as to all acts charged to him by the amended complaint appellee Glasner is protected by immunity by the laws of California.

3. The allegations of paragraph VIII of the amended complaint to the effect that defendants entered into an unlawful combination and conspiracy for the purpose of depriving appellant of his privileges and immunities guaranteed every United States citizen by section 1 of the 14th Amendment to the United States Constitution are conclusions of law, unsupported by any proper and sufficient factual allegations.

From the judgment of dismissal, plaintiff took this appeal.

Discussion herein will be had in the order specified and contained in the trial court's judgment of dismissal, rather than in the order set forth in appellant's opening brief.

ARGUMENT OF THE CASE.

I.

Lack of Appellant Individual's Standing to Sue for Alleged Interference With Corporation's Business.

In paragraphs II and III of his amended pleading, appellant alleges that from November, 1947, until August, 1960, he was engaged in the business of slaughtering and dispensing poultry, kosher and non-kosher, at a certain address in Santa Monica, California, under the fictitious firm name of West Coast Poultry Company; that in August, 1960, West Coast Poultry Company was organized as a California corporation; that appellant is president and general manager of said corporation; and that the corporation is a continuation of said poultry business. [Tr. p. 3, "II" and "III".]

It thus appears that since August of 1960 the business involved has been and is that of the corporation, West Coast Poultry Company. It also appears that the alleged acts are asserted to have taken place on or about April 1, 1964 [Tr. p. 4, line 10], at a time when the corporation was conducting the business. It is true that appellant alleged that he is one of the two stockholders of the corporate stock and is the president and general manager of the corporation. However, this does not make the business activities or customers or other business affairs those of appellant as an individual. These are and belong to the corporation which is the concern carrying on the business as alleged in appellant's pleading.

Appellant, as an individual, is the sole party plaintiff. It is evident that he seeks to ignore the corporate entity. That may not be done by him, either as stockholder or president or general manager. Appellant has no right as an individual to sue for redress of that which is the corporation's concern. These are the corporation's affairs, not appellant's.

"The fact that a stockholder owns all, or practically all, or a majority of the stock, does not of itself authorize him to sue as an individual." (13 Fletcher Cyc. Corp., 1961 ed., p. 366, §5910; Green v. Victor Talking Machine Co., 2 Cir., 1928, 24 F.2d 378, 380.) As observed in the anti-trust action in Skouras Theatres Corp. v. Radio-Keith-Orpheum Corp., D.C., S.D.N.Y., 1961, 193 F. Supp. 401, 407:

". . . In legal contemplation, the motion picture theatres injured by the alleged conspiracy were under control of the three sublessee corporations. and only those corporations were entitled to redress of the wrongs inflicted. The fact that plaintiffs were the landlords of the theatres avails them naught. [Citations.] Nor is plaintiffs' ownership of the sublessee corporations of any aid, for even a shareholder who owns the corporation cannot sue in its stead. [Citation.] Nor are plaintiffs' direct dealings with the defendants and their management of the business of the sublessees sufficient to confer upon them standing. 'Shareholders and officers of corporations as well as creditors and landlords have been held not to have standing to sue for treble damages.' [Citation.] The fact that plaintiffs have more than one of the above statutes does not lead to the conclusion that they have standing to sue. Plaintiffs created corporations to hold the theatres under subleases in order to obtain the benefits of such an arrangement. They may not now successfully pierce the veils of the corporate sublessees to avoid the burdens of the arrangement."

Or, as expressed in South Carolina Council of Milk Producers, Inc. v. Newton, D.C., E.D.S.C., 1965, 241 F.Supp. 259, 263, the rule is "an effective bar to suits by shareholders, officers, employees, and creditors, for personal losses caused by injury to the corporation. The cause of action accrues only to the corporation for which it can bring suit, or by a shareholder's derivative suit." To allege that the acts of a defendant or defendants have caused impairment or even destruction of the corporation's business or assets which thereby renders the stockholders' property (stock) less valuable or valueless or a creditor less secure or without security or an employee with lessened or no employment, does not operate to invest any of these persons with the corporation's cause or rights. (Ibid., and cases cited; see also, Gagnon v. Nevada Desert Inn. 1955, 45 Cal.2d 448. 289 P.2d 466; Toboni v. Pennington Millinery Co., 1959, 172 Cal. App. 2d 47, 341 P.2d 845; Cromelin v. Fulcher, 5 Cir., 1951, 192 F.2d 40; Brictson v. Woodrough, 8 Cir., 1947, 164 F.2d 107, cert.den. 334 U.S. 849, 68 S.Ct. 1500, 92 L. ed. 1772.)

The amended complaint shows that the corporation is a California corporation. Section 834, California Corporations Code, regulating the bringing of suits for redress of wrongs committed against a corporation, is not merely procedural but is held to apply to an action brought in the federal courts. (Koster v. Warren.

9 Cir., 1961, 297 F.2d 418, 419, citing Cohen v. Beneficial Industrial Loan Corporation, 1949, 337 U.S. 541, 69 S.Ct. 1221, 93 L.ed. 1528; see also Hausman v. Buckley, 2 Cir., 1962, 299 F.2d 696, 700, et seq.) The courts hold that the corporation's "rights, not those of the nominal plaintiff, are to be adjudicated, and the court has no jurisdiction to adjudicate its rights in its absence as a party." (Beyerbach v. Juno Oil Co., 1954, 42 Cal.2d 11, 28, 265 P.2d 1, 11; Keller v. Schulte, 1957, 47 Cal. 2d 801, 803, 306 P.2d 430, 432.) Appellant here has not complied with section 834, California Corporations Code.

Appellant's suit does not purport to a derivative suit on behalf of the corporation but is by himself solely as an individual. Appellant cites *Sutter v. General Petroleum Corp.*, 1946, 28 Cal.2d 525, 170 P.2d 898, for the proposition that a cause of action may exist "in favor of both the corporation and the stockholder." In *Toboni*, *supra*, 172 Cal.App.2d at p. 51, 341 P.2d at p. 348, it pertinently was said:

"Plaintiff mistakenly relies upon Sutter v. General Petroleum Corp., 28 Cal.2d 525 [170 P.2d 898, 167 A.L.R. 271]. It does not support her thesis. There the plaintiff sued for damages directly and individually sustained by him, caused by the fraud of the defendant which induced plaintiff to organize and invest in a corporation to take over an oil and gas lease and abandon his own petroleum development projects. The stock in the new corporation thus formed became valueless because of that fraud."

That is in nowise akin to that which here is presented.

Of course, the owner of a business has a property right therein with the right to make profit (livelihood) therefrom. But appellant is not the owner; the corporation, West Coast Poultry Company, is the owner of the business; and appellant's status, whether as a stockholder or president or general manager of that corporation, gives him no right as an individual to seek redress for any alleged damage done to the corporation. For example, Royal News Company v. Schultz, U.S.D.C., Mich., 1964, 230 F.Supp. 641 relied on by appellant as supportive of his right as an individual, was an action for injunction brought by the corporation whose products (books) unlawfully had been seized, thus depriving the corporation of its property without due process of law. The suit was by the corporation, not by any stockholder or officer or employee and the decision nowhere purports to invest these latter persons with any right to seek redress as individuals for that done to the corporation.

Appellant at great length argues that his business and his right to earn from that business are somehow involved because he and his wife are the sole stockholders and he is president and general manager of the corporation. Nowhere, however, does it appear that appellant himself is engaged in business. It expressly and affirmatively is alleged that the corporation was formed in 1960 and is a continuation of the business formerly

conducted by appellant. It is the corporation's business—not any business of appellant—that is involved and being conducted by the corporation. If there be any "interference" with that business or with the owner's right to earn a "livelihood" therefrom, it is an interference with the corporation's rights, not with appellant's individual rights. Appellant confuses the fact that there is a corporate entity and makes assertions that interference with the corporation constitutes interference with him as an individual. He, as an individual, cannot ignore the corporation or the fact that it is the corporation which is conducting the business.

In concluding his discussion of this matter, appellant claims (O. B. p. 20) that there are two allegations made of "overt acts" committed "directly to plaintiff, rather than through his corporation."2 He states that the pleading alleged that defendants communicated with customers of the plaintiff. However, the allegations show that West Coast Poultry Company, a corporation, was and is conducting the business. The reference to "customers of the plaintiff and the West Coast Poultry Company, a California corporation," made in the referred-to paragraph VIII of his pleading [Tr. p. 4, lines 19-20], clearly and obviously is a reference to customers of the business conducted by the corporation—for that is the only business alleged to exist in the pleading. His second claimed "direct" overt act, "that criminal complaints were filed against the plaintiff and not against the corporation", refers to the allegation that two criminal complaints were filed against plaintiff for violation of California Penal Code,

²Note: Appellant refers to the corporation as "his" corporation. This fallacious and erroneous conception appears to be the main basis for his argument in his point II.

section 383b. [Tr. p. 4, lines 27-28.] (See Erlich τ. Municipal Court, 1961, 55 Cal.2d 552, 11 Cal.Rptr. 758, 360 P.2d 334, upholding the constitutionality of the code section and refusing to prevent prosecution of appellant thereunder.) Certainly, the Civil Rights laws do not give any citizen the right to be immune from criminal charges being filed against him. The mere filing of such charges could not possibly have deprived appellant of any civil right. The appellant's pleading does not allege whether he ultimately was found guilty or not guilty of the charges filed against him. If found not guilty, he was not deprived of any civil right. (He does not claim that he was mishandled or abused, physically or mentally, or was deprived of counsel, etc., by appellee Glasner or any official or any of the defendants.) If found guilty, he was not deprived of any civil right for he violated the provisions of section 383b, California Penal Code, in such event. His allegation that two criminal charges were filed against him does not allege any violation of any civil right.

By paragraph IX of his pleading, appellant alleges, "That the interference by these defendants with the business of the West Coast Poultry Company is a direct interference with the right of the plaintiff to peaceably operate his business and earn a livlihood [sic] for himself and his family" and it is on this basis that he claims his "civil rights" (privileges and immunities) have been infringed. His suit does not purport to be a derivative one although it thus seeks redress for alleged interference with the business of the corporation. The trial court correctly held that the real party in interest was the corporation, not appellant individual, for it is the corporation which would suffer the dam-

age sought. Appellant as an individual has no standing to sue. For this reason alone, his suit properly was dismissed.

II.

Immunity of Appellee Glasner, California State Kosher Food Law Representative.

Appellant's amended pleading affirmatively alleges that appellee Glasner is the kosher food law representative employed by the California Department of Health. His duties include investigation of violations of the kosher food laws of California pursuant to California Penal Code, section 383b. (See also Appendix to this brief.) It is alleged that on or about April 24, 1964, appellee Glasner, "while acting in his official capacity as kosher food law representative of the State of California, but not within his duties as kosher food law representative", and all of the defendants did certain acts heretofore summarized in the Statement of the Case.

As kosher food representative of California, appellee Glasner is immune from suit in performance of his duties which rule "applies not only to acts essential to the accomplishment of the main purposes for which the office was created but also to acts which, although only incidental and collateral, serve to promote those purposes. (White v. Towers, 37 Cal.2d 727, 733 [235 P.2d 209, 28 A.L.R.2d 636].)" (Lipman v. Brisbane Elementary School Dist., 1961, 55 Cal.2d 224, 233, 11 Cal.Rptr. 97, 102, 359 P.2d 465, 470; Tiets v. Los Angeles Unified Sch. Dist., 1965 238 Cal.App.2d, 238 A.C.A. 1028, 1032, 48 Cal.Rptr. 245, 248.) The immunity of the kosher food law representative from suit for discretionary acts and that his duties are discre-

tionary in nature are well discussed and considered in Glickman v. Glasner, supra, footnote 1, 230 Cal.App.2d 120, 40 Cal.Rptr. 719. Argument there, as here, was made that his employment did not encompass that which was charged against him in the civil suit for damages. The argument was squarely met and determined against plaintiff Glickman in that case.

In *Hoffman v. Halden*, 9 Cir., 1959, 269 F.2d 280, the complaint alleged both a deprivation of privileges and immunities and a denial of due process of law. (See p. 286, footnote, allegation "VII".) On pages 298-300, discussion was had of the immunity of state officials. It was held (pp. 299-300):

"A broad holding that all state officials enjoyed immunity would be an improper approach. . . .

"The approach of granting immunity to government officials for discretionary acts done within the scope of their authority, seems a proper one. . . This approach says we will not inquire, subjectively—into their state of mind—where they are exercising a discretionary function."

This Court then cited the cases of Cooper v. O'Connor, supra, 1938, 69 App.D.C. 100, 99 F.2d 135, 118 A.L.R. 1440, and O'Campo v. Hardisty, 9 Cir., 1958, 262 F.2d 621, and stated that although neither were civil rights cases, "we are content to follow O'Campo v. Hardisty, supra and Cooper v. O'Connor, supra, in this case and extend immunity to a state officer for his discretionary acts within the scope of his authority."

In Cooper v. O'Connor, supra, on pages 139-140 of 99 F.2d, it was held that appellee Simon, agent and investigator of the Federal Bureau of Investigation, and

appellees O'Connor, Lyons, Awalt, Barse and Baldwin, agents and officers of the Comptroller, were immune from suit claiming damages for causing indictments to be returned against appellant for asserted violations of the banking laws. In connection with those in the Comptroller's office, it was said in part on page 140:

"The administration of criminal justice would be impossible without the active participation of public officials representing the departments concerned with the enforcement of particular laws. . . . By reason of their performance of duties clearly assigned, the facts and evidence which suggest criminal conduct upon the part of bank officials are revealed to such officers . . . In the case of an official, his failure to act under such circumstances would, in addition, constitute serious malfeasance in office. In the present case, appellees were charged with responsibility for the collection and conservation of the assets of a bank. It would be absurd to contend that the duties of such an officer - so charged and so peculiarly aware of facts suggesting that certain persons were engaged in the spoilation of those very assets - should stop abruptly at the point where the initiation of criminal proceedings became necessary to protect such assets. [Citations.]"

In *Hardy v. Vial*, 1957, 48 Cal.2d 577, 582-583, 311 P.2d 494, 496-497, it was held:

". . . The rule of absolute immunity, notwithstanding malice or other sinister motive, is not restricted to public officers who institute or take part in *criminal* actions. First recognized for the protection of judges (*Bradley v. Fisher*, 13 Wall.

(U.S.) 335 [20 L.Ed.646]), it has been extended by the federal decisions to all executive public officers when performing within the scope of their power acts which require the exercise of discretion or judgment. (Spalding v. Vilas, 161 U.S. 483 [16 S.Ct. 631, 40 L.Ed. 780]; Standard Nut Margarine Co. v. Mellon, 72 F.2d 557; United States, to Use of Parravicino v. Brunswick, 69 F.2d 383; Jones v. Kennedy, 121 F.2d 40 [73 App. D.C. 2921; Farr v. Valentine, 38 App. D.C. 413; De Arnaud v. Ainsworth, 24 App.D.C. 167 [5 L.R.A.N.S. 163]; see Papagianakis v. The Samos. 186 F.2d 257, 260-262.) In this state Downer v. Lent, 6 Cal. 94 [95 Am.Dec. 489], and Oppenheimer v. Arnold, 99 Cal. App. 2d 872, 874 [222 P.2d 940], recognize the same wide immunity. (Cf. also Wilson v. Sharp, 42 Cal.2d 675, 679 [268 P.2d 1062].)

"The policy underlying the doctrine of absolute immunity is well stated by Judge Learned Hand in *Gregoire v. Biddle*, 177 F.2d 579, 581, as follows: 'It does indeed go without saying that an official, who is in fact guilty of using his powers to vent his spleen upon others, or for other personal motive not connected with the public good, should not escape liability for the injuries he may so cause; and, if it were possible in practice to confine such complaints to the guilty, it would be monstrous to deny recovery. The justification for doing so is that it is impossible to know whether the claim is well founded until the case has been tried, and that to submit all officials, the innocent as well as the guilty, to the burden of a trial and to the inevitable

danger of its outcome, would dampen the ardor of all but the most resolute, or the most irresponsible, in the unflinching discharge of their duties. Again and again the public interest calls for action which may turn out to be founded on a mistake, in the face of which an official may later find himself hard put to satisfy a jury of his good faith. There must indeed be means of punishing public officers who have been truant to their duties; but that is quite another matter from exposing such as have been honestly mistaken to suit by anyone who has suffered from their errors. As is so often the case. the answer must be found in a balance between the evils inevitable in either alternative. In this instance it has been thought in the end better to leave unredressed the wrongs done by dishonest officers than to subject those who try to do their duty to the constant dread of retaliation.

"... It should be noted in this connection that 'What is meant by saying that the officer must be acting within his power [to be entitled to immunity] cannot be more than that the occasion must be such as would have justified the act, if he had been using his power for any of the purposes on whose account it was vested in him.' (*Gregoire v. Biddle,* 177 F.2d at p. 581.)..."

Gregoire v. Biddle, supra, 2 Cir., 1949, 177 F.2d 579, frequently has been cited, quoted and followed. Prefaced by the statement that, "The matter has been admirably expressed by Judge Learned Hand", the Supreme Court in Barr v. Mateo, 1959, 360 U.S. 564, 571-572, 79 S.Ct. 1335, 3 L.ed. 2d 1434, quoted and fol-

lowered the foregoing from *Gregoire*. (See also: *Bershad v. Wood*, 9 Cir., 1961, 290 F.2d 714, 719, stating, "The Supreme Court's acceptance of Gregoire v. Biddle impels us to the conclusion that the law has changed, and that it is now considered wise to leave some government agents entirely free from suit when they are acting within an area entrusted to their discretion."; *Ove Gustavsson Contracting Co. v. Floete*, 2 Cir., 1962, 299 F.2d 655, 658; *Norton v. McShane*, 5 Cir., 1964, 332 F.2d 855, 858, where, after quoting from *Gregoire*, it was said, "This statement of the law is made binding on us by the express approval afforded it by the Supreme Court in Barr v. Matteo, 1959, 360 U.S. 571-572, 79 S.Ct. 1335", and citing *Bershad* in the accompanying footnote.)

Appellant states that *Hoffman v. Halden, supra*, 9 Cir., 1959, 268 F.2d 280, was overruled by *Cohen v. Norris*, 9 Cir., 1962, 300 F.2d 24, on authority of *Monroe v. Pape*, 1961, 365 U.S. 167, 81 S.Ct. 473, 5 L.ed.2d 492. *Monroe* involved police brutality and unlawful searches and seizures in contravention of due process. *Cohen* likewise involved unreasonable search and seizure. As stated by this Court on page 27: "The constitutional right invoked by Cohen in the instant case is the due process clause of that amendment. He claims that he was subjected to an unreasonable search and seizure." The only portion of *Hoffman*, considered unsound by this Court in *Cohen*, was its holding that there must be an allegation of purpose to discriminate

or deprive one of a federal right predicated on an alleged violation of the due process clause. Thus, on pages 29-30, this Court stated:

"In our view Monroe v. Pape announces the rule that an allegation of a purpose to discriminate or a purpose to deprive one of any federal right, is not essential to the statement of a claim under §1983 predicated on an alleged violation of the due process clause of the Fourteenth Amendment. It is accordingly necessary for us to overrule in this respect the contrary holdings in our earlier decisions in Agnew v. City of Compton [239 F,2d 226] and Hoffman v. Halden, and to disapprove the contrary statement made by way of dictum in Walker v. Bank of America [268 F.2d 16]." (Italics and bracketed matter added.)

In *Rhodes v. Meyer*, 8 Cir., 1964, 334 F.2d 709, cert. den., 13 L.ed.2d 186, it was stated on page 718:

"In regard to the categories of officialdom previously determined immune in Houston, proper judicial administration requires us to follow such determinations unless there since has been a significant change in the applicable law. Plaintiff relies upon Monroe v. Pape, 365 U.S. 167, 87 S.Ct. 473, 5 L.Ed. 2d 492 (1961), for the contention that none of the defendants are immune under the Civil Rights Act and that the law set out in Houston is erroneous."

After quoting from *Rhodes v. Houston*, D.C.Neb., 1962, 202 F.Supp. 624, 629-630, aff'd, 8 Cir., 309 F.2d 959, cert.den., 372 U.S. 909, 83 S.Ct. 724, 9 L.ed.2d

719, the concluding sentence of which was, "This court, therefore relies upon its own reading of that case [Monroe v. Pape], and concludes that it has no effect upon the doctrine and is not here in point.", the Court of Appeals said [334 F.2d at p. 718]:

"This court has also since made a survey of the cases citing Monroe to see what effect, if any, it may have on the traditional concepts of immunity. We find that there is overwhelming support that judicial immunity and its derivative quasi-judicial immunity have not been affected by Monroe. See Harvey v. Sadler, 9 Cir., 331 F.2d 387 (1964); Agnew v. Moody, 9 Cir., 330 F.2d 868 (1964) (citing Houston with approval); Ray v. Huddeston, W.D.Ky., 212 F. Supp. 343, aff'd, 6 Cir., 327 F.2d 61 (1964); Crawford v. Zeitler, 6 Cir., 326 F.2d 119 (1964); Duzynski v. Nosal, 7 Cir., 324 F.2d 924 (1963) (citing Houston with approval); Hurburt v. Graham, 6 Cir., 323 F.2d 723 (1963); Sires v. Cole, 9 Cir., 320 F.2d 877 (1963); Nesmith v. Alford, 5 Cir., 318 F.2d 110 (1963); Weller v. Dickson, 9 Cir., 314 F.2d 598 (1963): Kostal v. Stoner, 10 Cir., 292 F.2d 492 (1961); Basista v. Weir, W.D.Pa., 225 F. Supp. 619 (1964); Norton v. McShane, 5 Cir., 332 F.2d 885 (1964).

"... The court properly determined all defendants to be immune from actions such as that alleged, and plaintiff's complaints were properly dismissed for failure to state a claim upon which relief could be granted."

This is not a case of alleged police brutality such as was involved in Monroe v. Pape, supra, 365 U.S. 167; nor a case of unwarranted search and seizure, coupled with assault on plaintiff's person, such as was involved in Cohn v. Norris, supra, 300 F.2d 24; nor a case of a prosecuting attorney, acting as police and seeking to intimidate a 16-year-old female by trick and deceit into confession to the crime of murder and without being informed of her right to counsel, etc., such as was involved in Robichaud v. Ronan, 9 Cir., 1965, 351 F.2d 533—cases cited and relied on by appellant. None of these decisions involved discretionary action of a state administrative official, such as appellee Glasner, California State Kosher Food Law Representative. Each and every act charged against appellee Glasner was and is "within the outer perimeter of [his] line of duty" and he has and is entitled to immunity from the fear of civil suits for damages in regard thereto. (Barr v. Mateo, supra, 360 U.S. 564, 575. See also pp. 570-572.)

The basic and fundamental reasons for governmental officer's immunity in performing the discretionary duties annexed to his office here are present. Under numerous decisions, some of which are cited hereinabove, that immunity sustains the trial court's judgment of dismissal.

III.

Pleading Conclusions of Law.

While this basis does not appear to have been one relied upon by appellee Glasner, it is the third and last reason contained in the trial court's specified reasons for the judgment of dismissal. At the outset, it may be noted that the record does not show that appellant requested, desired or wanted any leave to amend. Presumptions are in favor of the trial court's actions. Appellant does not suggest how or in what manner he could further amend his pleading so as to state any claim upon which relief could be granted against this appellee.

Even under the most liberal view of pleading, the plaintiff cannot plead or rely upon mere conclusions of law. There must be sufficient supporting allegations of fact to sustain the adequacy of a pleading for claimed redress under the Civil Rights laws. (See: Birnbaum v. Trussell, 2 Cir., 1965, 347 F.2d 86, 89-90, citing and quoting from Powell v. Workmen's Compensation Bd. of State of New York, 2 Cir., 1964, 327 F.2d 131, 137; International Harvester Company v. Kansas City, 10 Cir., 1962, 308 F.2d 35, 37-38, cert.den. 371 U.S. 948, 83 S.Ct. 503, 9 L.ed.2d 498; Halliburton Company v. Norton Drilling Company, 5 Cir., 1962, 302 F. 2d 431, 435 [3], cert. den. 374 U.S. 829, 83 S.Ct. 1870, 10 L.ed.2d 1052.)

It is unnecessary further to discuss this feature since it appears that the trial court's judgment correctly was had under either or both point I, *supra*, appellant individual's lack of standing to sue for alleged interference with corporation's business, and point II, *supra*, immunity of appellee Glasner, California State Kosher Food Law Representative.

CONCLUSION.

For the reasons and on the authorities herein contained, it is respectfully submitted that the judgment should and must be affirmed as to appellee Glasner.

Respectfully submitted,

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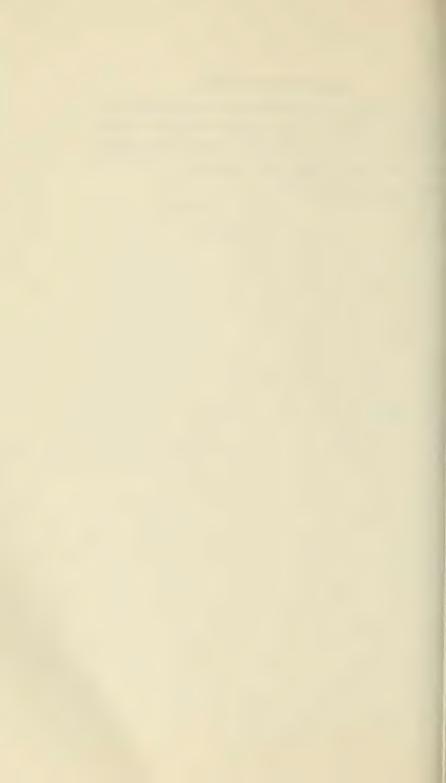
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Certificate of Counsel.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WAYNE VEATCH
Attorney







APPENDIX.

"California State Personnel Board Specification for Class of Kosher Food Law Representative

"Definition:

"Under the direction of the Chief, Bureau of Food and Drug Inspections, Department of Public Health, to carry out the statewide program of investigation and inspection in connection with the enforcement of the State Kosher Food Law; and to do other work as required.

"Typical Tasks:

"As assigned, in the major metropolitan areas of the State, initiates and carries out a field inspection program designed to secure understanding of and compliance with the State Kosher Food Law; visits and inspects meat and poultry markets offering kosher products for sale to assure that such products have been properly identified, labeled, segregated, advertised, and otherwise handled in a manner consistent with orthodox Hebrew religious ritual and custom; inspects establishments such as delicatessens, restaurants, catering firms, and rest homes purveying kosher foods to see that products sold as kosher are, in fact, kosher and that they have been processed and served in an manner and with dishes, utensils, and vessels prescribed by Hebrew law and customs; makes field surveys to determine that kosher foods are properly prepared, stored, processed, labeled, and advertised: meets with and advises interested persons such as kosher meat and poultry packers, wholesalers, retailers, and restauranteurs on application of the State Kosher Food Law and on proper practices to follow to insure compliance with this law; confers with violators of the Kosher Food Law in an effort to secure voluntary compliance with its provisions; conducts field investigations of complaints regarding kosher foods alleged to have been prepared, packaged, sold, or advertised in violation of the State Kosher Food Law; conducts investigations, gathers, assembles, and reports facts and evidence; assists in the preparation of cases for prosecution when necessary: works cooperatively with representatives of other governmental agencies including the State and Federal Departments of Agriculture and local law enforcement officials; prepares reports of field activities."

No. 20982

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DAVID ERLICH,

Appellant,

US.

JUDA GLASNER, CHAIM I. ETNER, BEZLIAL ORLANSKI, NEPTALI FRIEDMAN, OSHER ZILBERSTEIN; JUDA GLASNER, OSHER ZILBERSTEIN and CHAIM I. ETNER, doing business as the United Orthodox Rabbinate of Greater Los Angeles, United Orthodox Rabbinate of Greater Los Angeles, A. M. Bauman and Jacob Adler,

Appellees.

APPELLANT'S CLOSING BRIEF.

FILED

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DEC 0 19+5

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Appellees.

APPELLANT'S CLOSING BRIEF.

Preliminary Statement.

On a judgment entered in favor of the defendants in this cause following an order of the court that the amended complaint failed to state a claim upon which relief could be granted to plaintiff for violation of his civil rights (42 U.S.C.A. 1983, et seq.) plaintiff filed his appeal and submitted his Opening Brief on August 17, 1966.

On September 8, 1966 the defendant Juda Glasner filed his respondent's brief.

On September 8, 1966 Richard A. Perkins the attorney for the appellee Chiam I. Etner wrote to the Clerk of the United States Court of Appeal stating that

he would file no brief in behalf of the appellee Etner but in lieu thereof would adopt the brief heretofore filed by the other appellees.

On September 28, 1966 Mr. Phill Silver the attorney for United Orthodox Rabbinate of Greater California submitted a statement that because of stress of business he was unable to file his appellee's brief within the allotted time and requested an extension to October 27, 1966 to file his appellee's brief, which request was On November 20, 1966 Mr. Phill Silver wrote to the Clerk of the court stating that he would file no brief on behalf of the appellee United Orthodox Rabbinate and requested permission to adopt the brief of the appellee Glasner "In so far as it may be applicable to co-defendant, United Orthodox Rabbinate." Nothing is stated about the brief for the appellees Bezlial Orlansky, Neptali Friedman, Osher Zilberstein, and A. M. Bauman who are also represented by attorney Phill Silver [Tr. p. 29], and presumably they also are not interested in submitting an independent appellee's brief.

In any event the only appellee's brief before this court in this cause is the one interposed by the appellee Juda Glasner and appellant answers it accordingly.

I.

Regarding the Right of the Plaintiff David Erlich to Maintain the Present Action.

The trial court in holding that Erlich's amended complaint failed to state a claim upon which relief could be granted, held that the injury done by the defendants, if any, was done to the West Coast Poultry Company, a California corporation and not to plaintiff as an individual. [Tr. pp. 35-36.] Appellant Erlich in his opening brief argued that the conduct of the appellees was pursuant to a conspiracy to destroy his right to own the property and to deprive him of his right to earn a livelihood for himself and his family, all in violation of the privileges and immunities guaranteed to him by Section I, Article XIV of the United States Constitution. (Op. Br. pp. 10-21.) Appellee does not attempt to answer plaintiff's contentions, but instead argues that Erlich's cause of action is derivative in nature. (App. Br. pp. 11-18.)

On page 12 appellee states:

"The fact that a stockholder owns all, or practically all, or a majority of the stock, does not of itself authorize him to sue as an individual."; and refers to several authorities in support thereof.

As propositions of law, unquestionably appellee's authorities are correct. But they are not applicable to the present situation where the crux of Erlich's complaint is that the defendants were directing their arrows directly at him as an individual and not to the corporation. Glasner makes no attempt to explain why, if in the performance of his duties as Kosher Food Law Inspector he was concerned with a violation of California Penal Code, Section 383(b) by the West Coast Poultry Company, a California corporation, he lodged a criminal complaint against David Erlich personally, rather than against the corporation. In California a corporation may be charged with a crime. (Cal. Penal Code, Sec. 7.) If West Coast Poultry Company, a California corporation was violating California Penal Code, Section 383(b), why was it necessary to file criminal complaints against employees of the corporation, rather than the corporation itself. [Tr. pp. 4-5.] If West Coast Poultry Company, the corporation was the violator, why was it necessary for the defendants to solicit Sam Salter and John Reyna to testify falsely against Erlich. [Tr. p. 5, para. g.]

Thus it is crystal clear that David Erlich was the object of defendant's aggressive action, and not the corporation; and that when the corporation was assailed it was done only with the purpose of injuring Erlich, and not molesting the corporate entity. Since Erlich, and only Erlich, was the direct and only objective of the defendant's conduct, they should not be permitted to escape liability for their acts on the misplaced theory that since the only way they could harm Erlich was through the corporation, the corporation was the only injured party.

On page 15 appellee states:

"Appellant at great length argues that his business and his right to earn from that business are somehow involved because he and his wife are the sole stockholders and he is president and general manager of the corporation. Nowhere, however, does it appear that appellant himself is engaged in business."

What appellee blithely ignores is that although West Coast Poultry Company is a corporation, it is identified by the public with the plaintiff, and not as a corporate entity separate and apart from the plaintiff. It is to be noted, which appellee evidently does not, that the defendants circulated advertisements in Los Angeles newspapers advising the public not to purchase any of plaintiff's Kosher products and not the corporation's. [Tr. p. 3, para b.]

On page 17 of this brief appellee argues that Erlich should not complain because he was the defendant in a criminal action, since every person who is suspected of having committed a crime should not object to charges being filed against him and be required to stand trial as to his innocence. As appellee states:

"The mere filing of such charges could not have possibly deprived appellant of any civil right."

Appellee ignores the point. Appellant was not charged with a crime because there were facts sufficient to charge him with one, but because he would not retain the rabbinical services of the defendants. [Tr. p. 3, para. VI.] After six weeks of trial on the first charge, the jury found him not guilty in less than an hour. Why then was it necessary to prosecute him a second time for violating Penal Code, Section 383(b) when it was a foregone conclusion that no conviction on the merits could possibly result. Nor should it be overlooked that to obtain a conviction that plaintiff violated Penal Code, Section 383(b) on the second trial, defendants were willing to employ false testimony. [Tr. p. 5, para. g.]

Of course whether the defendants were actually performing their duty, or, as it is alleged in the complaint, conspiring to force the plaintiff to employ the rabbinical services of the defendants and using the civil service position of the defendant Glasner a State employee to coerce the plaintiff into compliance, are questions of fact that should be determined by a trier of fact after an answer is filed (Attreau v. Morris (7th Cir. 1966), 357 F. 2d 871, 874.)

II.

Regarding the Immunity of Appellee Glasner, California State Kosher Food Law Representative.

Under his Point II (App. Br. pp. 18-26), Glasner argues that as California State Food Law Representative, he has absolute immunity from prosecution for any violation under the civil rights law. Although appellee does not agree with the decision of the United States Supreme Court in *Monroe v. Pape*, 365 U.S. 167, 81 S. Ct. 473, the point is that under the law as it exists today appellee Glasner has no immunity from an action under the Civil Rights law. (App. Op. Br. pp. 8-10 and *United States v. Price* (1966), 383 U.S. 787, 86 S. Ct. 1152.)

Rhodes v. Meyer (8th Cir. 1964), 334 F. 2d 709, cert. den. 1964, 379 U.S. 915, 85 S. Ct. 263 (App. Br. p. 24) merely repeats the oft cited exception that judges, legislators and prosecutors are the only one exempt from suits for violation of the Civil Rights Act. This exception certainly does not include the California State Kosher Food Law Representative.

III.

Regarding Pleading of Conclusions of Law.

As appellee Glasner states, he did not argue that the plaintiff pleaded Conclusions of Law as a basis for dismissing the amended complaint. (App. Br. p. 27.)

As a matter of fact no one did, and the first inkling anyone had that the court considered plaintiff's allegations that his Constitutional rights under the 14th Amendment were violated as Conclusions of Law, was when the court entered its own judgment [Tr. p. 36.]

Appellee adds nothing to support this ruling by the trial court, or that it is correct, and since this point is covered in Appellant's Opening Brief (Appellant's Opening Brief pages 21-22), there is no need for further elaboration.

IV.

Conclusion.

The amended complaint does state a claim upon which relief can be granted. The judgment of the trial court should be reversed and defendants given an opportunity to answer.

Respectfully submitted,

Joseph W. Fairfield and Ethelyn F. Black, Attorneys for Appellant.



Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH W. FAIRFIELD



IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY, Appellant,

JESSIE GEDDINGS THOMPSON, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON. NORTHERN DIVISION

HONORABLE WILLIAM J. LINDBERG, Judge

BRIEF OF APPELLANT: CONTINENTAL CASUALTY COMPANY

SKEEL, MCKELVY, HENKE, EVENSON & UHLMANN W. PAUL UHLMANN Attorneys for Appellant

Office and Post Office Address: 1020 Norton Building Seattle, Washington 98104



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IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,

Appellant,

v.

JESSIE GEDDINGS THOMPSON,

No. 20999

Appellee

Appeal from the United States District Court for the Western District of Washington, Northern Division

Honorable William J. Lindberg, Judge

BRIEF OF APPELLANT: CONTINENTAL CASUALTY COMPANY

LEGEND OF ABBREVIATIONS USED IN BRIEF

CT-Clerk's Transcript, of record as prepared by Clerk of U. S. District Court.

Ex-Exhibit. Exhibits were offered only by plaintiff; none by defendant.

RT-Reporter's (Court) Transcript, of evidence and proceedings in U. S. District Court (typewritten).

JURISDICTION

The plaintiff Jessie Giddings Thompson is a resident of the State of Washington and sued the defendant Continental Casualty Company, an Illinois corporation, in the United States District Court for the Western District of Washington, Northern Division. The amount in controversy is over \$10,000.00. The action is on contract to recover the face amount of an accident insurance policy in the sum of \$25,000.00 resulting from the death of the insured Ralph Everett Thompson. The District Court had jurisdiction under 28 USCA Sec. 1332. Upon the close of plaintiff's evidence the defendant interposed its challenge to the legal sufficiency of plaintiff's evidence to sustain any recovery and moved for a directed verdict (R.T. 358-361). That motion was denied (R.T. 361). The defendant elected to stand on its motion (R.T. 361). The trial resulted in a \$25,000.00 verdict for the plaintiff (C.T. 30). Within ten days after the verdict, defendant filed its Motion for Judgment N.O.V. (C.T. 31-32) and its Motion for a New Trial (C.T. 33-35). Each motion was denied (C.T. 36), whereupon Judgment on the Verdict was entered (C.T. 37-38). Within 30 days thereafter Notice of Appeal from said Judgment (C.T. 39) was served and filed and the required appeal bond was also filed. Jurisdiction for this appeal is based on 28 USCA Sec. 1291.

STATEMENT OF CASE

1. Background of Litigation

This action is on contract to recover the face amount of an accident insurance policy in the sum of \$25,000. It was a group policy, written by American Casualty Company of Reading Pennsylvania, in favor of the International Organization of Masters, Mates and Pilots (referred to as Union), and its members.

The group policy No. AA17171 (Ex. 4) was issued and

delivered to the Union at its home office in Washington, D. C. on January 1, 1962, the date on which it became effective. The insured Thompson, as a member of the Union, was enrolled under the group policy and became insured thereunder for accidental death resulting from bodily injury in the amount of \$25,000, effective July 1, 1962, when Certificate No. 169 (Ex. 3) was issued to him by American Casualty Company.

After the policy was issued, the defendant Continental Casualty Company, an Illinois corporation, took over and assumed all of the risks for which American Casualty Company was liable under the terms of this and other policies written by American Casualty Co.

Both American Casualty Company and Continental Casualty Company are parties defendant to the action and by reason of the assumption of liability by Continental, judgment was entered only against Continental Casualty Company.

The action was originally commenced by Jessie Giddings Thompson, the widow of the deceased insured, Ralph Everett Thompson, in her capacity as executrix of his estate. Because of the fact that Mrs. Thompson, personally, was the beneficiary named in the policy, she was substituted as the plaintiff by order of the District Court (C.T. 9).

QUESTIONS PRESENTED AND POINTS ON WHICH APPELLANT INTENDS TO RELY

a. The death of the insured, Ralph Everett Thompson, was not a "loss resulting directly and independently of all other causes" from "bodily injury" which was "caused by

accident" as defined by the terms of the insurance policy upon which plaintiff sues (Ex. 4). This issue was specifically pleaded by defendant in its answer, as its first affirmative defense (C.T. 6-7).

- b. The court erred in refusing, upon the close of plaintiff's evidence, to sustain the defendant's challenge to the legal sufficiency of plaintiff's evidence and to grant defendant's motion for dismissal or a directed verdict. Any verdict of the jury in its determination of the cause of death, under the evidence, could be based only on conjecture and speculation as urged by defendant in its motion for directed verdict, (R.T. 358-361), its Motion for Judgment N.O.V. (C.T. 31) and its Motion for New Trial (C.T. 33).
- c. The court erred in submitting the case to the jury for determination.
- d. The court erred in receiving and directing to be entered, the verdict of the jury.
- e. The court erred in entering its Judgment against the defendant, dated March 18, 1966.
- f. The court erred in denying defendant's Motion for Judgment N.O.V.
- g. The court erred in denying defendant's Motion for New Trial.
- h. The court erred in entering its order, dated March 18, 1966, denying defendant's Motion for Judgment N.O.V. or for a new trial.
- i. The court erred in refusing to give defendant's requested Instruction No. 10 and defendant's supplemental requested Instruction No. 1.

. Summary of Facts

The only factual issue in dispute in this action is whether he death of the insured resulted "directly and independently of all other causes" from "bodily injury caused by accident" as defined in the insurance policy sued upon. All other material facts are either agreed or supported by accontradicted testimony.

At the time of his death Mr. Thompson was 47 years of age. He was just under 6' 3" tall and weighed in the neighborhood of 212 pounds (R.T. 210). He was big-boned R.T. 210) and huskily built (R.T. 21). In July, 1961, he underwent an operation for gallstones and appendectomy, and before that had had a little history of ulcers (R.T. 209-210). After his operation he appeared to be in good nealth.

Mr. and Mrs. Thompson were married in 1949 (R.T. 208-209) and at the time of Mr. Thompson's death were esidents of Monroe, Snohomish County, State of Washington. Proof of loss was duly and timely made by Mrs. Thompson as required by the terms of the policy.

The following facts are undisputed. The SS CHENA was and is a liberty-type, steam-propelled freighter owned and operated by Alaska Steamship Company. The insured Thompson had served as the Third Officer upon said wessel from about February 21, 1964 (R.T. 305), until his death on March 28, 1964, during which time he appeared to be in good health and had performed his duties satisfactorily.

On Good Friday, March 27, 1964, the CHENA was tied up at the dock in Valdez, Alaska. At the time the earthquake commenced, approximately 1731 Hours A.S.T. (5:31

P.M.) (Ex. 6), Thompson was on watch aboard the CHENA performing his duties as Third Mate. The earthquake shocks were severe and were followed by large tidal waves. The docks and warehouses completely disintegrated and were destroyed in a matter of minutes. The vessel was tossed about on waves as high as 40 feet and at one point was carried inshore some 300 or 400 feet (R.T. 23). As the waters receded and flowed back and forth during successive tidal waves, the vessel vibrated and was hoved down a number of times on her beam ends in the debris and soft mud in the location where the disintegrated docks and warehouses had been. She rolled and tossed heavily and finally became affoat in the harbor at approximately 1750 Hours A.S.T. (5:50 P.M.) (Ex. 6) after which it experienced no further violence. During this activity much cargo aboard the CHENA was thrown about in the holds, in which nine longshoremen were working, two of whom were killed and one critically injured (R. T. 58).

Shortly after the first shock the insured made his appearance in the pilot house and carried out the orders of the captain to sound the "boat stations" (abandon ship) signal on the ship's whistle (Ex. 6, p. 3) (R.T. 10, 62). The insured remained on the bridge only a few minutes after which he left.

Before discussing Mr. Thompson's activities after leaving the bridge, attention is invited to these facts. Before the earthquake, Mr. Thompson had been very emotionally disturbed as a result of the tragedy of the explosion of the vessel Bunker Hill in which some of his friends and acquaintances were killed. Mr. Thompson had previously served aboard the Bunker Hill (R.T. 306-307) which blew

up on March 6, 1964 (R.T. 304), after he signed on the crew of the CHENA on February 21, 1964 (R.T. 305).

Chester Leighton, the chief engineer of the CHENA, testified that Thompson had been very "shook up" because of the Bunker Hill incident and his friends getting killed on her (R.T. 201). Thompson had said he knew most of the officers on that ship (R.T. 196). Leighton also testified (R.T. 196) that after the Bunker Hill incident, Thompson was going to quit going to sea because "he couldn't take it any more." He also testified that in the ship's salon at meals Thompson brought up the subject of the Bunker Hill frequently (R.T. 196-198).

The chief officer on the CHENA, Neil Larson, also testified (R.T. 132) he had heard Thompson discuss the Bunker Hill incident on occasions in the mess hall.

Captain Stewart also testified that he heard Thompson discussing the Bunker Hill while they were at dinner (R.T. 71). The foregoing incidents are material in light of evidence and statements made by Thompson after he left the bridge.

Apparently the chief officer Larson was the first to see Thompson in one of the passageways on the vessel after he left the bridge. At that time, Larson asked Thompson to go aft with the sailors, who were already there, to help clear the lines from the propeller (R.T. 118). He stated that as Thompson was walking down the passageway, in sort of a daze, he was banging his arms to his head and saying "The Bunker Hill and now this. The Bunker Hill and now this" (R.T. 118). The next time Larson saw Thompson he was lying in his bunk and Larson looked in a medical book in the room for shock treatment where it said to

elevate the lower body and wrap the patient up and keep him warm. He then got the steward and they elevated Thompson's lower body and put several blankets on him (R.T. 120-121).

The chief engineer, Leighton, also encountered Thompson on the engineer's deck as Thompson was going to his room. Leighton described him by saying that Thompson had his hands down at his sides, he was shaking like a leaf and just bearing straight ahead and saying "Bunker Hill, and now this." (R.T. 187, 196).

Dr. Clarence Davis, Jr., who examined Mr. Thompson aboard the CHENA, was engaged in general practice as a private physician in Valdez, Alaska. He arrived aboard the CHENA by launch at about 2100 Hours A.S.T. (9:00 P.M.) March 27 (Ex. 6, page 3). While aboard he attended Mr. Thompson. When he first saw him, Thompson was pale and perspiring. He complained of pains in the front of his chest and that he was short of breath. Thompson's blood pressure was around 120 over 90, his pulse was around 100, his abdomen was unremarkable, his chest was clear to palpitation, and he was orientated but frightened (R.T. 155). Dr. Davis administered morphine sulphate i.m. and placed Mr. Thompson on absolute, strict bed rest. The patient became somewhat more relaxed within the next 45 minutes to an hour when Dr. Davis took some of his past history (R.T. 155). The patient stated he had never had chest pains before; however, he had had some evidence of shortness of breath when he laid down. The patient then went to sleep (R.T. 155). The doctor checked him at intervals during the night and Thompson rested quite peacefully. His blood pressure remained stable and his pulse within normal ranges (R.T. 156). Before Dr. Davis left the CHENA at 0443 Hours A.S.T. (4:43 A.M.), March 28, Mr. Thompson awoke and complained of more chest pains. Dr. Davis gave him another quarter grain of morphine and did not see him again (R.T. 156). The doctor diagnosed the patient's condition as myocardial infarction. Mr. Thompson died at 0745 Hours A.S.T. (7:45 A.M.), March 28, 1964 (Ex. 6, page 4) (Ex. 1, Item 7a and b).

There is no evidence in the case that the insured sustained any traumatic bodily injury as the result of falling, being struck by an object, or accidentally coming in contact with any foreign object or otherwise. The captain testified Thompson went into a state of shock (R.T. 15) but sustained no bodily injury (R.T. 65). The captain also reported to the Coast Guard (Ex. 7, Item 22b) in answer to the question "Nature of injury" that Thompson suffered "No injury; state of shock" and that the cause of death (Ex. 7, Item 22d) also (Ex. 6, page 2) was "Coronary." Dr. Davis testified he examined the insured and found no evidence of traumatic injury to either his body or brain (R.T. 165). In the death certificate (Ex. 1), signed by Dr. Davis, he described Thompson's injury (Ex. 1, Item 27) as "Shock caused by earthquake" and reported the cause of death (Ex. 1, Item 19) as "Acute myocardial infarction."

Dr. Davis testified that Mr. Thompson had what may be termed free floating anxiety (R.T. 158), which he described in layman's language:

"Free floating anxiety is anxiety without foundation. It is an anxiety that overrides a person's judgment and reason." (R.T. 159).

It is undisputed that no autopsy was performed. Dr. Davis admitted on cross examination that his diagnosis of "acute myocardial infarction" is not an "absolute" in the medical sense, but a clinical diagnosis, and also that death might have resulted from some other cause (R.T. 163). The doctor also testified (R.T. 163) that Thompson did not indicate he had suffered any traumatic injury which he received as the result of the earthquake or shifting of the vessel.

In explaining the term "psychic trauma," which Dr. Davis used in attempting to describe Mr. Thompson's condition, he testified that the word "psychic" means something within the mind as distinguished from the brain or the physical components; and that it "is a completely mental process" (R.T. 164). He also testified "that the trauma was to his (Thompson's) thinking rather than to any part of his body or brain" (R.T. 164-65) (Emphasis supplied). The doctor also admitted that Mr. Thompson might have had a myocardial infarction had there been no earthquake (R.T. 165).

Dr. Glenn T. Strand, a psychiatrist, was called as an expert witness by plaintiff (R.T. 271). He did not attend Mr. Thompson. He testified that "psychic trauma" would "represent a stress reaction on the part of the individual, initially at the *mind* or *mental* level, with its additional ramifications and effects upon the physiology or physical mechanism of the body as well" (R.T. 272). He then went on to describe the *possible* chain reactions in the system which the sensation of fear *can* produce and how certain organs *could* respond thereto.

In further explaining reactions of individuals who become frightened he expressed the opinion that it has to do with the predispositional make-up and life experiences of the individual and with factors covering his inheritance, constitution, shock characteristics and what he came into life with, to begin with. It has to do with the nature of the precipitating circumstances themselves that are effecting him; and which may be of particular significance to one person as opposed to another who would not view the situation the same (R.T. 277). The doctor also explained that with respect to one under the influence of psychic trauma that decomposition may occur at a number of different levels, depending upon what is finally manifested to the observing physician (R.T. 277-278).

In addition, the doctor testified he would say that myocardial infarction is a pathological condition of the heart organ or cardiac-musculatore, in which the heart generally has been deprived of either its nutrients or oxygen so that it becomes a piece of dead or dying tissue within the heart musculatore, accompanied usually by a proven symptomology, and it may affect the maintenance of life of the individual as well (R.T. 278-279).

On cross examination, the doctor explained his understanding of the term myocardial infarction which can result from inefficient functioning of the heart as distinguished from the actual death of the heart tissue (R.T. 284).

Further on cross examination, Dr. Strand testified that myocardial infarction is not occasioned by one cause alone (R.T. 284). It can be caused by anything which interferes with the normal blood flow through the coronary circulation of the heart (R.T. 285); by constriction of arteries or blood vessels themselves (R.T. 285); by occlusion or ob-

struction (R.T. 286-287); by a clot, which is a rather common cause and which may be formed either in an area near the heart or further away (R.T. 287); or by a hemorrhage (R.T. 288).

The doctor explained that the ailment of sclerosis, or hardening of the arteries, begins in persons in the embryo before birth and continues to develop gradually thereafter and is more prevalent in persons of the masculine gender (R.T. 288). He acknowledged that myocardial infarction can be caused by an embolism which results from a free floating body which becomes detached from the inside of a sclerotic blood vessel into the blood stream which can carry it to the heart (R.T. 289-290). He testified also that this gradual sclerotic occlusion has been one of the most prominate causes of myocardial infarction (R.T. 292).

Other conditions responsible for myocardial infarction, he testified, include a condition of altered conduction of impulses to the heart, coming from the brain; interference with the conduction system of the heart itself (R.T. 290), or an occlusion or closing of the ostium (R.T. 291). He admitted also on cross examination that myocardial infarction can and frequently does happen to persons even when they are not under stress or undergoing extreme physical exertion (R.T. 291-292) and that it can happen to one while lying in bed (R.T. 292). Also he said that myocardial infarction may be caused by such things as extreme burns, extreme infection, bodily injury, being hit by something or being shot (R.T. 291-292). Further the doctor testified that one cannot determine with absolute certainty the cause of myocardial infarction without an

autopsy, and although an accurate clinical diagnosis in a large percentage of cases can be made, an autopsy is the best means of rendering confirmation of its cause (R.T. 293-294).

It is interesting to note also the doctor's testimony (R.T. 294 - 295) that myocardial infarction frequently causes shock.

On redirect examination (R.T. 296) when asked "is fright bodily injury as defined by yourself?" the doctor answered that "In the physiological context, fright *can* constitute bodily injury in terms of the changes most of which are reversible but some can be irreversible" (R.T. 296). He explained reversible as being the ability of the system to overcome the physical changes induced by fright. However, on re-cross examination, the doctor was asked:

- "Q. Doctor, isn't it true that in the ordinary sense the words 'bodily injury' mean contact with some foreign object?
- "A. I think that is the way I grew up to understand the term." (R.T. 298).

SUMMARY OF ARGUMENT

- 1. Since this action is one founded on contract, the limits of the liability of the insurance company cannot be extended beyond the risks assumed by it under the terms of the insurance contract or policy.
- 2. The facts proved in this case do not establish that the insured's death resulted "directly and independently of all other causes" from "bodily injury" caused by accident within the meaning of those terms as used in the policy.
 - 3. In refusing to grant Defendant's challenge to the legal

sufficiency of Plaintiff's evidence and its Motion for a Directed Verdict, on the close of Plaintiff's evidence; and in refusing to give Defendant's Supplemental Instruction No. 1, for a directed verdict in favor of Defendant; and further in denying Defendant's Motion For Judgment N.O.V. or its Motion for a New Trial; and permitting the verdict of the jury in favor of the Plaintiff in the sum of \$25,000.00 to be filed; and thereafter entering Judgment in favor of the Plaintiff for the amount of the verdict, the Court permitted recovery under the policy based on conjecture and speculation as to the cause of the insured's death.

4. The Court should have given to the jury Defendant's requested Instruction No. 10 (Appendix A) to the effect that where, from the evidence, death might have resulted from one of several possible causes, the jury could not indulge in conjecture or speculation as to which of the alternative causes might have been responsible for death.

ARGUMENT

Possibilities of Cause of Death

The death certificate (Ex. 1) states the cause of death as "acute myocardial infarction" resulting from shock caused by earthquake. Dr. Davis, the only physician who attended the deceased, admitted that since no autopsy was performed his diagnosis was not "absolute" and that death might have resulted from some other cause. (R.T. 163)

The testimony of the chief engineer, Leighton, is clear that the insured, after the explosion of the Bunker Hill on March 6, 1964, discussed that tragedy frequently (R.T. 196-198, 201) and was so badly "shook up" that he contemplated quitting the sea because he couldn't take it anymore. The repeated references by the insured immediately following the earthquake to "The Bunker Hill, and now this" indicates clearly that before the earthquake Mr. Thompson was suffering rather profound emotional disturbances. In characterizing Mr. Thompson's condition at the time he examined him, Dr. Davis used the expressions "free-wheeling anxiety" and also "psychic trauma."

In light of the testimony of both of Plaintiff's doctors that the cause of death cannot be determined with absolute certainty without the benefit of an autopsy, which was never performed, the jury had to speculate as to the cause of death.

The evidence is clear that whatever the cause of Mr. Thompson's death may have been, it was not induced by traumatic injury to his "body" or "brain," but by something which originated in the level of the insured's "mind," "thinking," or "mental" processes. See testimony of Dr. Davis (R.T. 164-165). Also, Dr. Strand's testimony is that "psychic trauma" represents a stress reaction which has its inception at the "mind" or "mental" level which, in turn, induces other physiological body reactions (R.T. 272).

Thus, the stress reactions which the insured experienced from the Bunker Hill incident might have been sufficient to have caused an embolism, which is the detachment of substance or tissue from the inside of a sclerotic blood vessel, which thereby gets into the blood stream and is ultimately carried to the heart. That is one of the most

prevalent causes of myocardial infarction (R.T. 292). Or, the stress from the Bunker Hill incident may have caused a clot to form, another common cause of myocardial infarction (R.T. 287) at any time preceding the earthquake, which did not reach the heart until the approximate time of the earthquake. Or, the myocardial infarction could have resulted from any one of the other numerous causes to which that affliction can be attributed as demonstrated by Dr. Strand's testimony set forth earlier in this brief. Myocardial infarction might even have *caused* the shock which the insured suffered (R.T. 294-295) or it could have occurred while the insured was simply lying in bed (R.T. 292).

Words Used in Contract Must Be Construed According to Their Ordinary Meaning

By the terms of the insurance contract here under consideration the insurance company agreed to pay the benefits under the policy

"for loss resulting directly and independently of all other causes from injury sustained" (Emphasis supplied)

by the insured person. The term "injury" is defined in the first paragraph of the policy (Ex. 4) as follows:

"Injury whenever used in this policy means bodily injury caused by accident occurring while this policy is in force with respect to the insured person. . . ." (Emphasis supplied)

It is defendant's position that the facts do not sustain plaintiff's position that death resulted "directly and independently of all other causes" from "bodily injury" caused by accident within the meaning of those words as used in the policy. The adjective "bodily" means "pertaining or belonging to the body; it is opposed to mental." (Webster). See also: Guardian Life Insurance Co. of America v. Richardson, 129 S.W.2d 1107, 1115, 23 Tenn. App. 194; and Terre Haute Electric Ry. Co. v. Lauer, 52 N.E. 703, 706, 21 Ind. App. 466.

In the case of *Provident Life and Accident Insurance Co. v. Campbell*, 79 S.W.2d 292, 296, 18 Tenn. App. 452, action was brought for recovery under double indemnity policies which obligated the insurers for double indemnity if loss resulted "solely from bodily injuries effected directly and exclusively by external, violent and accidental means. . . ." The insured drove his automobile over an infant child, as a result of which he suffered mental shock. The insured died about 30 minutes after the accident. The Court held, at page 304:

"... a purely 'mental shock' due to excitement or 'mental disturbance' such as that disclosed by the proof in the record before us is not a bodily injury within the contemplation of the insurance contracts involved in these cases."

The term "bodily injuries" was construed in *Chase v. Businessmen's Assurance Co. of America*, (C.C.A. 10) 51 F.2d 34, as follows:

"In their ordinary and popular sense, the phrase, 'bodily injuries' conveys the idea of a cut, bruise or wound, rather than a physical impairment caused by disease." (page 36).

In that case, the policy provided insurance against loss of life only where the death resulted "from bodily injuries effected solely through accidental means." Death resulted from typhoid fever induced by the insured's con-

sumption of polluted water. Recovery was denied.

Also, in *Burns v. Employers' Liability Assur. Corp. Ltd. of London*, 134 Ohio St. 222, 16 N.E.2d 316, 117 A.L.R. 733, the Court construed the words "bodily injury" as used in an accident policy; and near the end of the opinion stated:

"The words 'bodily injury' are commonly and ordinarily used to designate an injury caused by external violence, and they are not used to indicate disease. We do not speak of sickness as an accident or an injury. When we hear that someone has suffered an accident, we conclude that he has suffered, more or less, some external violent bodily injury. Since the words 'bodily injury' are used in the policy in their common and accepted meaning, it is only by a strained and illogical construction of the words that they can be held to include a disease not resulting from some external violence. We do not think of one suffering from typhoid fever as being bedridden as the result of an accident or injury.

"In order to create liability under a policy insuring against bodily injuries caused directly, solely and independently of all other causes by accidental means, there must be evidence of some external or violent and accidental force or cause."

The following statement of the rule is found in 44 C.J.S. 1155 under the title "Insurance" §294, "Meaning of Language":

"A contract of insurance should be construed according to the sense and meaning of the words, or terms of the policy, and, if clear and unambiguous, according to their plain, ordinary, usual, and popular sense, unless they were intended to have, or have acquired, a different meaning, or unless their construction by their ordinary meaning would lead to an unreasonable or absurd result."

See also: Chase v. Businessmen's Assurance Co. of America, (C.C.A. 10) 51 F.2d 34, 36; Lincoln National Life Insurance Co. v. Erickson, (C.C.A. 8) 42 F.2d 997, 1001.

On the question of construction of insurance policies, the Court made the following significant statement in London Guaranty and Accident Co. v. Leefson, (C.C.A. 3d) 37 F.2d 488 at page 489:

"There is perhaps a natural tendency to treat accident insurance policies as though their terms were uniform, but the rights arising from them are contractual, and must be determined with careful reference to the terms of each policy."

Both the plaintiff and the trial court in this action took the position that the issues in the pending action are controlled by the decision of the Washington State Supreme Court in the case of *Pierce v. Pacific Mutual Life Insurance Co.* (1941) 7 Wn.2d 151, 109 P.2d 332. That was an action by an insured to recover under an accident policy which insured against bodily injury sustained solely through accidental means resulting directly, independently and exclusively of all other causes, in total disability.

While the insured in that case was driving his automobile through an intersection he suddenly saw two cars approaching him from opposite directions. One of the approaching cars was partly on the insured's side of the highway. The insured became badly frightened, thinking that under the circumstances he would be unable to avoid a collision. In an endeavor to avoid the collision, he slammed on the brakes of his car, which proceeded at an angle toward the opposite side of the street and came to a stop. The insured became aware of a feeling of weakness in his right arm and by the time his car came to a

stop he had lost consciousness. There was no collision and the insured sustained no external injuries. After regaining consciousness, the insured proceeded to his office and shortly thereafter was taken to a physician who diagnosed his condition as a cerebral hemorrhage or stroke. On appeal the trial court's judgment for the defendant was reversed.

The principal question material to the case at bar, decided by the Supreme Court was: whether or not fright, or mental shock, unaccompanied by physical impact, is sufficient to constitute "accidental means" within the terms of the policy. The Supreme Court in its decision did not specifically construe the words "bodily injury" as used in the policy. The court stated the question and its answer in this language: (160)

"The second specific question raised is whether or not fright, or mental shock, unaccompanied by physical impact, is sufficient to constitute 'accidental means' within the purport of that term as used in the policies.

"It has been definitely settled in this jurisdiction, in negligent cases, that damages are recoverable for personal physical injuries resulting from fright, even though there is no physical impact involving the person sustaining the fright, provided that the negligent act of the defendant was the proximate cause of the fright, such physical injuries being distinguishable from purely mental distress or psychological disorders." (Emphasis supplied) (160)

The opinion went on to state:

"Although the case at bar is an action upon a contract, and not one arising in tort, the principle of law above stated is equally applicable to both situations. The element of fright supports recovery, not because of the peculiar nature of the action brought, but be-

cause its connection with physical injury has been recognized. The question is simply one of proximate cause; the nature of the action brought is immaterial." (162)

Thus while the *Pierce* case is authority for the rule that fright, under the factual situation in that case, was an "accidental means," the court did not in its opinion specifically construe the words "bodily injury."

The Supreme Court of Texas rendered a very significant decision in the case of Pan American Life Insurance Company v. Andrews (1960) 340 S.W.2d 787. Actions on two separate accident policies were consolidated for trial. The language in these policies were similar and both were more elaborate than the language in the policy involved in the case at bar or in the case of Pierce v. Pacific Mutual Life Insurance Company, supra. In the policy written by the Continental Company, in the Andrews case it was provided that the company would be liable if:

"the death of the Insured has resulted from bodily injuries, effected directly and independently of all other causes through external, violent and accidental means..."

The policy states that "This supplemental contract does not cover death resulting from:

"(a) Bodily injuries of which there is no visible contusion or wound on the exterior of the body, except in case of drowning or internal injury revealed by autopsy..."

In this case a fire occurred on December 4, 1953 in the building where the insured had his office. He observed the fire and seemed to be nervous. On the following day it was noticed that he walked with a limp, and on that day the insured called on his doctor and told him, with

considerable emotion, that the fire was very serious so far as he was concerned; that it had him "in a jam" because his records were practically destroyed and it was near the end of the year. Several days thereafter the insured developed some loss of sensation in his extremities and his condition progressively deteriorated. He was examined by a neurologist on December 22 and hospitalized on December 25. On January 4 he underwent brain surgery and died on January 7, 1954, 34 days after the fire. His doctor, who attended him, testified he was of the opinion that the thing that set off the chain reaction that produced his condition was "probably" "psychic trauma"; and that "the fire produced the reaction in his mind, which is capable of producing damage to the cells tissue not only in the brain, but other organs." Another doctor testified he was of the opinion that there was a reasonable probability that the psychic trauma suffered by the insured as the result of the fire, was the cause of the thrombosis.

In commenting on the evidence, the court pointed out, page 789,

"The psychic trauma was brought about by the anticipation on the part of the insured that records of personal property located in the building were being damaged or destroyed and by the natural concern over the loss of the contents in the insured's office."

An autopsy was performed and only showed the presence of the thrombosis which the doctor testified was "probably" caused by psychic trauma (789). The court commented on the contention of the respondent that where a person suffers physical injury resulting from fright or mental shock caused by the wrongful torturous act of an-

other, that the injured party is entitled to recovery damages; but it stated at page 789:

"We do not agree, however, that this rule applicable in tort law is to be followed in determining the rights of parties under contractual provisions."

Later in the decision, the court points out, at page 792, that the injury here was wholly and solely caused by a "mental reaction" and then stated:

"Seemingly the intention of the parties as disclosed by the double indemnity contract was that before recovery could be had it must be determined, with some degree of certainty that death resulted from an accidental injury, but here we have speculation on speculation. It is speculated that the deceased suffered psychic trauma and then it is speculated that the psychic trauma produced a thrombosis." (Emphasis supplied) (792)

The court said further: (792)

"We can see no distinction between the case at bar and a fatal attack of heart failure suffered by an insured induced by the excitement of watching a football game on a television program or in fact worry brought about by financial or domestic problems if that mental disturbance is said to have caused a thrombosis which in turn caused death."

The opinion concluded in part with the statement, at page 794:

"There being no evidence that the insured suffered death as a result of bodily injuries effected solely through external, violent or accidental means, recovery of double indemnity benefits must be denied."

In his concurring opinion to the Pan American v. Andrews case Judge Smith pointed out that based on the evidence the trial court could not have impliedly made findings which would not include those: that the "wit-

nessing" of the fire produced a "mental" reaction (described as psychic trauma) which was the *means* through which a clot in the arteries was effected; and also that these *means* were entirely mental or psychic, wholly, free of and unaccompanied by any physical force (795). The judge further points out in his concurring opinion, page 795, that:

"The policies simply do not afford coverage where the cause of death was an unanticipated reaction to the insured's environment."

and also that

"The most that can be said of the medical testimony offered by the petitioner is that the petitioner's doctors testified that the witnessing of the fire by the insured may have caused psychic trauma and was a possible cause of the insured's death." (Emphasis supplied)

Judge Smith said also:

"It should be noted that double indemnity coverage is provided in both policies for bodily injury only. It is clear from the evidence that the image or contents of the insured's brain and nervous system was not the sole efficient cause, independent of all other means or causes of the cerebral arterio-thrombosis; but that the sole cause of his death came about as the result of the intervening agency of his mind and nervous system working on the image which was an entirely internal means, and, therefore, not external." (795)

"... In the present case, there is no physical trauma which can be traced into the insured's body as the sole cause of the insured's death, without the intervention of any other causal means." (796)

Jury Could Not Indulge in Speculation or Conjecture

The Trial Court erred in refusing to give defendants' Requested Instruction No. 10 (Appendix A), and particu-

larly all portions thereof after the first sentence in the instruction as requested. Exceptions to the Court's refusal to give this instruction were taken during the trial (R.T. 388, 389). The jury should have been instructed, as requested in said instruction, that it could not speculate as to the cause of the insured's death. The actual cause of death was not established with reasonable certainty but, rather, by circumstantial evidence, or supposition on supposition. The rule covering such a situation is well stated in the case of *Arnold v. Sanstol*, (1953) 43 Wn.2d 94, 99, 260 P.2d 527, as follows:

"Such evidence may be direct or circumstantial. When reliance is placed upon the latter type of evidence, there must be reasonable inferences to establish the fact to be proved. No legitimate inference can be drawn that an accident happened in a certain way by simply showing that it might have happened in that way, without further showing that reasonably it could not have happened in any other way. The facts relied upon to establish a theory by circumstantial evidence must be of such a nature and so related to each other that it is the only conclusion that fairly or reasonably can be drawn from them. A verdict cannot be founded on mere theory or speculation. If there is nothing more tangible to proceed upon than two or more conjectural theories, under one or more of which a defendant would be liable, and under one or more of which there would be no liability upon him, a jury will not be permitted to conjecture how the accident occurred. Gardner v. Seymour, 27 Wn.2d 802, 808, 180 P.2d 564 (1947), and cases cited; Carley v. Allen, 31 Wn.2d 730, 737, 198 P.2d 827 (1948); Stevens v. King County, 36 Wn. 2d, 738, 747, 220 P.2d 318 (1950), and cases cited."

This Court, in the case of Brownlee v. Mutual Ben. Health & Accident Ass'n, (C.C.A. 9) 29 F.2d 71, 72, recognized the rule set forth in the preceding case and held

that where the evidence in an action on an accident insurance policy is such that the jury can only speculate or guess as to the cause of death, the defendant is entitled to a directed verdict. See also: Reading Co. v. Boyer (C.C.A. 3d) 6 F.2d 185; Philadelphia & R. Ry. Co. v. Cannon (C.C.A. 3d) 296 Fed. 302; Spain v. Oregon-Washington R. & N. Co., 78 Or. 355, 153 Pac. 470, Ann. Cas. 1917E, 1104; Medsker v. Portland R., L. & P. Co., 81 Or. 63, 158 Pac. 272.

In two decisions by the Supreme Court of Washington, the court cited with approval the following statement from 9 Blashfield, *Cyclopedia of Automobile Law and Practice* (part 2, Perm. ed.) 520, Sec. 6126:

"The burden of proving proximate cause is not sustained unless the proof is sufficiently strong to remove that issue from the realm of speculation by facts asserting a logical basis for all inferences necessary to support it." Wilson v. Northern Pacific R. Co. (1954) 44 Wn.2d 122, 129, 265 P.2d 815; Paddock v. Tone (1946) 25 Wn.2d 940, 949, 172 P.2d 481.

The Supreme Court of Washington also stated in Stevens v. King County (1950) 36 Wn.2d 738, 747, 220 P.2d 318:

"We have frequently said that, if there is nothing more tangible to proceed upon than two or more conjectural theories under one or more of which a defendant would be liable and under one or more of which a plaintiff would not be entitled to recover, a jury will not be permitted to conjecture how the accident occurred."

To the same effect see *Gardner v. Seymour* (1947) 27 Wn.2d 802, 809, 180 P.2d 564; and *Carley v. Allen* (1948) 31 Wn.2d 730, 738, 198 P.2d 827.

The Trial Court also erred in refusing to give defend-

ants' Requested Supplemental Instruction No. 1 (Appendix A) directing a verdict in favor of the defendant. This subject has already been fully covered in this brief and need not be repeated here.

CONCLUSION

Since this is an action on contract, the insurance company is liable only to the extent of the risks it undertook to insure against and because of the failure of the Plaintiff to prove that death resulted "directly and independently of all other causes" from "bodily injury caused by accident" as its terms are commonly used and understood, the Judgment of the trial court should be reversed.

Respectfully submitted,

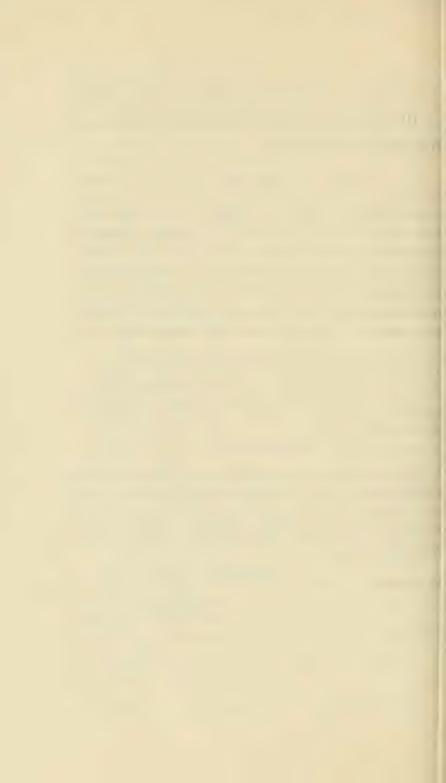
W. Paul Uhlmann
Of Attorneys for Appellant

CERTIFICATE

I hereby certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and, that in my opinion the foregoing brief is in full compliance with those rules.

Respectfully submitted,

W. Paul Uhlmann
Of Attorneys for Appellant



APPENDIX A

DEFENDANTS' REQUESTED INSTRUCTIONS

Defendants Requested Instruction No. 10:

You are instructed that when reliance is placed on circumstantial evidence to establish the cause of death, there nust be reasonable inferences from the facts presented rom which you can conclude that death was caused as claimed, that is, directly and independently of all other causes from bodily injury caused by accident. No conclurive inference can be drawn that Mr. Thompson's death esulted from a specific cause simply by proof that it might have resulted from that cause, unless you are reasonably satisfied it could not have happened in any other way. The facts relied upon to establish a theory of the cause of leath must be of such a nature that it is the only logical conclusion that fairly or reasonably can be drawn from he facts. Your verdict cannot be founded only on theory or speculation. If from the evidence it appears that there s more than one conjectural theory as to what may have caused the death, under one or more of which the insurance company would be liable, and under one or more of which there would be no liability upon it, you are not pernitted to conjecture as to what caused the death.

Defendants' Requested Supplemental Instruction No. 1:

You are instructed to return a verdict in favor of the defendant Continental Casualty Company.

APPENDIX B

APPENDIX OF EXHIBITS

The following numbered trial Exhibits constitute part of the record (CT 43). All Exhibits were Plaintiff's Exhibits, references to them are made only by the designation "Ex." References are to RT (Reporter's Transcript).

Exhibit N	7o.	Identified	Offered	Admitted
Plaintiff's	1	16	98	99
Plaintiff's	2	16	105	106
Plaintiff's	3	16	105	106
Plaintiff's	4	16	105	106
Plaintiff's	5	16	300	302
Plaintiff's	6	17	17	17
Plaintiff's	7	93	358	358
Plaintiff's	8	93	100	101
Plaintiff's	9	93	102	103

SKEEL, McKelvy, Henke, Evenson & Uhlmann

W. PAUL UHLMANN

Attorneys for Appellant

IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY, L E D

Appellant, AUG 5 1966

JESSIE GIDDINGS THOMPSON, B. LUCK, CLERK Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON,

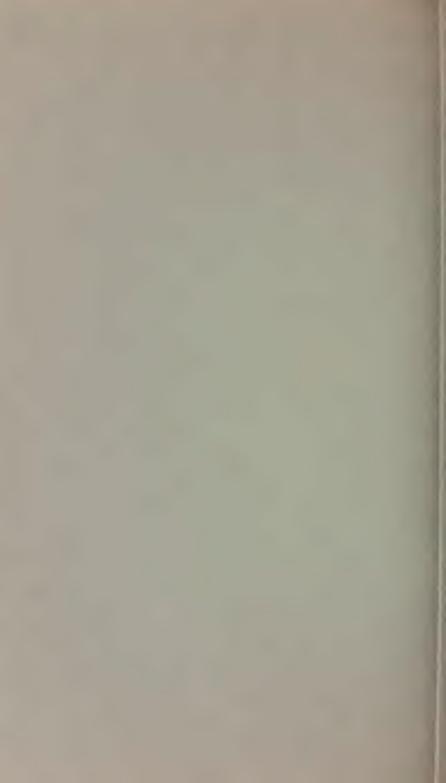
NORTHERN DIVISION

Honorable William J. Lindberg, Judge

BRIEF OF APPELLEE: JESSIE GIDDINGS THOMPSON

SORIANO & SORIANO
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Attorneys for Appellee

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IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,

Appellant,

 \mathbf{v} .

JESSIE GIDDINGS THOMPSON,

Appellee

No. 20999

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

Honorable William J. Lindberg, Judge

BRIEF OF APPELLEE: JESSIE GIDDINGS THOMPSON

LEGEND OF ABBREVIATIONS USED IN BRIEF

CT-Clerk's Transcript of record as prepared by Clerk of U.S. District Court.

Ex-Exhibit. Exhibits were offered only by plaintiff; none by defendant.

RT—Reporter's (Court) Transcript of evidence and proceedings in U.S. District Court (typewritten).

App. br.—Appellant's brief.

l.—line.

STATEMENT OF JURISDICTION

Appellee agrees with appellant that jurisdiction in this matter is vested in the United States Court of Appeals for the Ninth Circuit by virtue of 28 U.S.C.A. §1291. The United States District Court for the Western Dis-

trict of Washington, Northern Division, rightfully maintained jurisdiction based on 28 U.S.C.A. §1332. Appellant has met the procedural requirements necessary to appeal the cause.

APPELLEE'S COUNTER-STATEMENT OF THE CASE

1. Background of Litigation

Appellee Jessie Giddings Thompson is the surviving spouse of Ralph Everett Thompson, deceased. She is the named beneficiary under American Casualty Company of Reading, Pennsylvania, Group Policy No. AA17171 (Ex. 4), Certificate No. 169 (Ex. 3), issued July 1, 1962. The group policy insured union members of the International Organization of Masters, Mates and Pilots against injury or death caused by accidental means. Contractually, Ralph Everett Thompson's life was insured by enrollment under said plan in the amount of \$25,000.00.

On March 28, 1964, Thompson became deceased. Subsequent thereto, his surviving wife qualified as executrix of Thompson's Last Will and Testament. Included in the estate were accidental death insurance policies. One was with Traveler's Insurance Company and the second with American Casualty Company of Reading, Pennsylvania, hereinafter referred to as "American." Pursuant to contract, Proofs of Loss were submitted to the proper representatives of each company. Traveler's Insurance Company paid the accidental death benefits to the beneficiary in the amount of \$5,000.00. In approximately the month of July or August, 1964, it was learned by the beneficiary's attorneys that a merger had been effectuated between appellant and American or that appellant

had purchased American. Demands were made of appellant's representatives and after a considerable length of time, appellant denied appellee's claim. Appellee commenced suit and filed the same November 3, 1964 (CT 1).

2. Summary of Facts

On March 27, 1964, Ralph Everett Thompson was employed in the capacity of Third Officer on board the vessel SS CHENA. The vessel is owned and operated by Alaska Steamship Company, a Washington corporation. She is a Liberty-type vessel which was reconditioned for the hauling of vans in the Alaska trade. Thompson, aged 47, was married and resided with his wife on a farm outside Monroe, Snohomish County, State of Washington. He was a competent deck officer, well capable of performing his duties. At the time of Thompson's demise, he was free of infirmities and appeared in excellent health. His death resulted from the trauma sustained during the Alaskan Good Friday earthquake, March 27, 1964. Thompson went into shock and became deceased on March 28, 1964.

The magnitude of the earthquake would be described as horrible and devastating. The SS CHENA was moored to its dock in Valdez, Alaska. At approximately 5:31 p.m., Alaska Standard Time, the earthquake struck. The vessel was tossed about by tremendous tidal waves; stevedores were killed by tumbling cargo and ship's paraphernalia. Humans were buried alive in chasms created by the quake, and the entire dock and warehouse facility was destroyed.

Thompson, as cargo watch officer, was obliged to resume his duties on the bridge of the vessel at the outset of the earthquake. While in the performance of his duties, Thompson went into shock. He never recovered from said condition and succumbed at 7:45 a.m., Alaska Standard Time, the morning of March 28, 1964.

Evidence submitted to the jury at the time of trial clearly established that Thompson met his death due to bodily injury caused by accidental means.

SUMMARY OF ARGUMENT

- 1. Thompson's death was within the purview of the insurance contract.
- 2. The insured's death resulted directly and independently of all other causes from "bodily injury" caused by accident within the terms of the policy.
- 3. The only witnesses before the jury were appellee's. There could not possibly have been conjecture or speculation on the part of the jury. Appellant's position that cross-examination in the realm of generalities produced plausible explanations of Thompson's death is not logically founded, but was considered by the jury.
- 4. The death of Thompson was accidentally caused while he was working as third officer on board the SS CHENA at Valdez, Alaska; that his injury occurred three minutes after the commencement of the Good Friday earthquake and the injury occurred as described—"Shock caused by earthquake."

ARGUMENT

Cause of Death

The certificate of death (Ex. 1) signed and recorded April 16, 1964, set forth the cause of death as acute myocardial infarction due to earthquake. The condition which gave rise to the underlying cause was the earthquake. There were no other significant conditions contributing or relating to Thompson's death. The certificate sets forth the circumstances as being an accident, wherein Thompson was injured at 5:34 p.m., March 27, 1964, while at work and described the injury as shock caused by earthquake. Also please refer to the Proof of Death, Physician's Statement No. 1 (Ex. 8), completed by Dr. Davis and submitted to American Casualty Company of Reading, Pennsylvania, by the surviving spouse. Dr. Davis further expressed the acute myocardial infarction as being immediate and caused by the stress of the Good Friday earthquake.

Dr. Davis attended the deceased during the evening of March 27, 1964. When he first observed the patient, Thompson was very pale; he was perspiring and his pulse was rapid (RT p. 155, ll. 3-15). Dr. Davis further testified that the cause for Mr. Thompson's state of shock was fright due to the earthquake (RT p. 157, ll. 16-23). The doctor categorized Thompson's condition as psychic trauma. Thompson was unable to compensate reality due to his condition (RT p. 159, ll. 6-16). Dr. Davis testified, in his opinion, had it not been for the earthquake of March 27, 1964, Thompson would not have experienced the shock condition. The psychic trauma experienced by Thompson became an unsurmountable barrier which had the effect of overloading Thompson's heart (RT p. 167, ll. 14-25; p. 168, ll. 1-2).

One of the leading psychiatrists in the Seattle area, Dr. Glen T. Strand, was called as an expert witness by appellee. He was asked what effect fright could produce.

His statement to the jury and to the court was categorical that fright could kill a person (RT p. 281, ll. 19-25; p. 282, ll. 1-4). Further, the jury was informed by Dr. Strand that fright is the most prevalent cause of shock; that fright itself would produce bodily injury (RT p. 295, ll. 24-25; p. 296, ll. 1-2, ll. 23-25; p. 297, ll. 2-22).

Considerable mention has been made in appellant's brief that the deceased was emotionally disturbed due to the explosion of the SS BUNKER HILL and the subsequent loss of said vessel and a number of the officers employed on board her. It was admitted in appellant's brief that the deceased, while serving on board the SS CHENA, was a very capable and competent ship's officer. The master of the SS CHENA, Merrill Stewart, the chief officer, Neil Larsen, and the chief engineer, Chester Leighton, all testified in concert that Thompson performed his officer's duties capably and without restriction of any sort. It would be certain that an explosion such as experienced on board the BUNKER HILL would be a topic of conversation and that the loss of friends and shipmates would be disturbing to any normal person. In light of that, the chief officer, Neil Larsen, who was most closely associated with Thompson, testified that Thompson brought up the subject of the loss of the BUNKER HILL and his friends infrequently (RT p. 132, ll. 6-17). In fact, politics seemed to be the topic of conversation.

Chester Leighton, chief engineer, in his deposition, stated that Thompson discussed the BUNKER HILL incident quite often after it happened (RT p. 198, ll. 11-12). Leighton also testified that he was not well acquainted with the deceased.

The master of the CHENA, Merrill Stewart, testified that he had heard Thompson discuss the BUNKER HILL on only *one* occasion, while the officers were having dinner (RT p. 71, ll. 12-21).

A theory that Thompson was disabled due to the BUNKER HILL incident was pure conjecture and speculation. On the basis of the record it would appear that appellant's theory was a subterfuge considered by the jury and the jury determined that the explosion of the BUNKER HILL had no causal effect upon Thompson's physical condition on the 27th day of March, 1964. The master succinctly testified that Thompson went into shock due to fright. That the fright was consistent with the magnitude of the earthquake and all persons aboard the CHENA, together with most persons in the vicinity, were very much frightened by the experience (RT p. 55, ll. 3-5).

Words Used in the Insurance Policy Were Construed by the Jury According to Their Ordinary Meaning.

The trial court instructed the jury (RT p. 373, ll. 21-25; p. 374, ll. 1-7) as follows:

"The plaintiff would be entitled to recover under said policy only if you find that Mr. Thompson's death resulted from a cause insured against within the reasonable contemplation of the parties as expressed by the language of the policy.

"In construing the contract, or policy of insurance, the terms and words used therein usually should be given their *ordinary meaning* as they are *commonly used* and understood. The law presumes that the parties understood the import of their contract and that they intended to be bound by the language of the policy." (Emphasis supplied)

In Ames v. Baker, 68 W.D.2d 709, the court pronounced the rule as follows:

"It is well established that the language of an insurance policy should be interpreted in accordance with the way it would be understood by the average man purchasing insurance. Zinn v. Equitable Life Ins. Co., 6 Wn.2d 379, 107 P.2d 921 (1940). Nice distinctions and refinements are not favored. Rather than interpreting the policy in a technical sense, the court should interpret the policy in accordance with its ordinary meaning. Thompson v. Ezzell, 61 Wn.2d 685, 379 P.2d 983 (1963), and authorities cited. Words used in a policy of insurance should be given their common, ordinary meaning, rather than that of the lexicographers or of those skilled in the niceties of the language. 13 Appleman, Insurance Law and Practice, §7384 (1943)."

Insurance Contract Is Interpreted in Favor of the Insured.

Further, in Ames v. Baker, supra, at page 710 the court stated as follows:

"Finally, even if the intentions of the insurer and the insured do not coincide and even if defendant's interpretation is arguably plausible, rendering the policy capable of two interpretations, the judgment must nevertheless be affirmed. When a policy is fairly susceptible of two different interpretations, that interpretation most favorable to the insured must be applied, even though a different meaning may have been intended by the insurer. Thompson v. Ezzell, supra; Selective Logging Co. v. General Cas. Co. of America, 49 Wn.2d 347, 301 P.2d 535 (1956)." (Emphasis supplied)

The jury acted on the instructions of the trial judge and concluded that fright caused bodily injury to Thompson within the terms of the insurance policy.

Appellee, in her trial memorandum, cited the case of Pierce v. Pacific Mutual Life Insurance, 7 Wn.2d 151,

109 P.2d 332 (1941). The court in that case applied the words "Physical injuries" rather than "bodily injuries." It is submitted that physical injuries by its dictionary definition means the same.

The courts have held that the death or injury of a person may result from shock, fright or other psychic trauma despite absence of physical impact by the insured's body and a force causing death or injury. In the case of Pierce v. Pacific Mutual Life Ins. Co., supra, the Washington Supreme Court found that where an attorney who suffered a cerebral hemorrhage as a result of being confronted with another vehicle approaching him in his traffic lane, was permitted recovery under a policy insuring against disability sustained "solely through accidental means." The Washington State Supreme Court noted that excitement, fright and sudden physical exertion, and other mental, emotional or physical activity have the effect of raising a person's blood pressure, and that the injuries then and there sustained by him [Pierce] were sustained through accidental means. In certain instances, recovery has been permitted where the insured was a mere witness to the events alleged to have been the stimulus producing the shock, fright, or psychic trauma resulting in death. The case of Fairclough v. Fidelity & Casualty Co., 54 App. D.C. 286, 297 F. 681 (1924), the Appellate Court noted that the insured's fall resulted from "Psychic shock" or a faint produced by temporary nervous derangement brought on by fear or fright. They further ruled that if the jury had found such to be the fact, the vertigo would not have barred recovery upon the policy.

The testimony in this case indicated that Thompson was sympathetic in nature. That the catastrophe follow-

ing the earthquake and the ensuing tidal waves caused him to go into deep shock from which he never recovered.

In the case of *International Travelers'* Association v. Branum (1914, Tex. Civ. App.), 169 SW 389, the court rejected the theory that plaintiff did not die from accidental means. The court held that great excitement was capable of producing death from cerebral hemorrhage.

In the Pierce case, supra, the court reviewed the guestion as to whether fright or shock suffered by the insured was the sole proximate cause of his injury and resulted directly, independently and exclusively of all other causes in his disability within the provisions of the policy. The Washington State Supreme Court found that in such cases the injury should stand out as the predominant factor in the production of the result and held that while the insured may have had a diseased condition which deprived him of the normal power of resistance to the effects of undue strain or fright and such condition may have been necessary to the result, the insured's pre-existing condition did not necessarily deprive the strain or fright he suffered or its character as the predominant factor in the production of the cerebral hemorrhage so as to preclude recovery under the policy.

Appellant cited Pan American Life Insurance Company v. Andrews, 340 S.W.2d 78 (1960), (App. Br. p. 21). It is interesting to note that the Branum case supra, was not overruled here. In the Andrews case, Washington's Pierce case was cited and distinguished. (Emphasis supplied.) In the Andrews case, the policy stated that "This supplemental contract does not cover death resulting from:

"(a) Bodily injuries of which there is no visible contusion or wound on the exterior of the body, except

in the case of drowning or internal injury revealed by autopsy..."

In the instant case there were no qualifying clauses setting forth or restricting the nature of the injury. The jury was instructed to contemplate whether or not a bodily injury was sustained by Thompson as a result of the Good Friday earthquake. It deliberated that Thompson sustained bodily injury which caused Thompson's death.

In distinguishing the various cases involving psychic trauma, the courts have alluded to the difference between imminent danger to life, as against loss of property, and further, the question of whether or not the insured has been voluntarily or involuntarily subjected to the element of psychic trauma. In the Pan American Life Insurance Company v. Andrews, supra, the Texas Supreme Court concluded that the deceased insured voluntarily had witnessed a fire which was destroying his property; that he had no personal danger and suffered no fright. In fact, the insured was not in the building at the time of the fire.

Jury Did Not Indulge in Speculation or Conjecture.

The appellant contends that it was error for the court's failure to give appellant's Instruction No. 10 (RT p. 388, ll. 4-25; p. 389, ll. 1-12). The trial court explained the instructions and further stated that the instruction as proposed by appellant was not analogous. Testimony and exhibits alleviated conjecture and speculation. As set forth in appellee's brief, the only speculation or conjecture that could have been entertained by the jury would be in weighing the collateral matters suggested by appellant while arguing its case and cross examining the witnesses.

Trial Court Could Not Grant a New Trial or Judgment N.O.V.

The Supreme Court of the State of Washington has followed the federal rule and has set forth the test to be applied in the granting or denying of a motion for new trial and/or a judgment N.O.V. *Bunnell v. Barr*, 68 W.D.2d 764; at page 767 the court stated:

"It is axiomatic that we, as is the trial court, are bound to the rule that in considering the issues raised by a motion for new trial the evidence of the nonmoving party must be accepted as true and, together with all reasonable inferences that may be drawn therefrom, be interpreted in a light most favorable to that party. Davis v. Early Constr. Co., 63 Wn.2d 252, 386 P.2d 958 (1963). Likewise, we are cognizant of the principle that, except where questions of law are involved, the trial court is invested with broad discretion in granting or denying motions for new trial, and that the trial court's determination will not be disturbed on appeal absent an abuse of discretion. Cyrus v. Martin, 64 Wn.2d 810, 394 P.2d 369 (1964); Sargent v. Safeway Stores, Inc., 67 W.D.2d 933, 410 P.2d 918 (1966). This latter principle, however, does not constitute a license for the trial court to weigh the evidence and substitute its judgment for that of the jury, simply because the trial court disagrees with the verdict. Knecht v. Marzano, 65 Wn.2d 290, 396 P.2d 782 (1964)."

"The basic underpinning of the trial court's action in granting a new trial in the instant case is found in the principle, announced in *Mouso v. Bellingham & No. Ry.*, 106 Wash. 299, 303, 179 Pac. 848 (1919) to the effect that:

"'[W]here the physical facts are uncontroverted and speak with a force that overcomes all testimony to the contrary, reasonable minds must follow the physical facts,'

"This rule, however, does not apply when the physical facts in evidence go no further than to simply cast

doubt upon the credibility of a witness or a party. Shephard v. Smith, 198 Wash. 395, 88 P.2d 601 (1939). On the contrary, to properly apply the rule, the physical facts in evidence must not only be undisputed, they must also be consistent with each other and, when taken together, be manifestly irreconcilable with the countervailing oral testimony. In short, the established and undisputed physical facts must be such as to irresistably lead reasonable minds to but a single conclusion."

CONCLUSION

On the basis of the evidence, appellee considered that she was entitled to a directed verdict. The trial court apparently felt that the matters introduced by appellant through cross examination would perhaps cause reasonable minds to differ. Instructions covering the entire case were given to the jury. After deliberation, the jury concluded the verdict for the plaintiff (appellee).

Respectfully submitted,

SORIANO & SORIANO
MILTON H. SORIANO
Attorneys for Appellee

CERTIFICATE

I hereby certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and, that in my opinion the foregoing brief is in full compliance with those rules.

MILTON H. SORIANO
Of Attorneys for Appellee



IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,
Appellant,

v.

Jessie Giddings Thompson, SEP - 2 1966 Appellee.

WM B LUCK, CLER

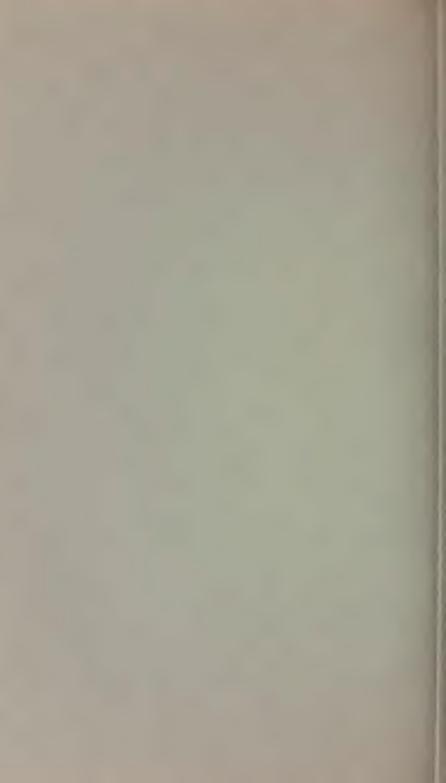
Appeal from the United States District Court for the Western District of Washington, Northern Division

HONORABLE WILLIAM J. LINDBERG, Judge

REPLY BRIEF OF APPELLANT: CONTINENTAL CASUALTY COMPANY

SKEEL, MCKELVY, HENKE, EVENSON & UHLMANN
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IN THE

United States Court of Appeals For the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,

Appellant

v.

No. 20999

JESSIE GIDDINGS THOMPSON,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

Honorable William J. Lindberg, Judge

REPLY BRIEF OF APPELLANT: CONTINENTAL CASUALTY COMPANY

LEGEND OF ABBREVIATIONS USED IN BRIEF

R.T.—Reporter's (Court) Transcript of evidence and proceedings in U. S. District Court (typewritten).

RE STATEMENT OF CASE

Appellant is astounded by the statement appearing in Appellee's brief relative to the alleged Travelers Insurance Company accident policy on the life of the deceased, Ralph Edward Thompson. In referring to that policy, Appellee stated on page 2 of the brief, under the heading Background of Litigation,

"Travelers Insurance Company paid the accidental death benefits to the beneficiary in the amount of \$5,000."

Apparently the inference sought to be implied by that statement is that if Travelers Insurance Company paid an accidental death claim under an accident policy, payment should also have been made under the policy which is the subject of this litigation. Even if the statement made is a fact, it has no relevancy in this case. There is no evidence on that subject in this record. None was even offered. The terms of the Travelers Insurance Company policy are not before this Court; and we can only assume, therefore, that the risk was fully covered thereunder. None of the facts or circumstances with respect to either the fact or reasons for such payment are in this record. Appellant respectfully submits, therefore, that the statement is not only immaterial and irrelevant but also improper because it goes outside the record and this Court must, therefore, wholly disregard it.

RE APPELLEE'S COUNTERSTATEMENT OF CASE

On page 4 of Appellee's Brief under the heading of Summary of Facts is the statement that

"... Thompson met his death due to bodily injury caused by accidental means."

Appellee makes no reference in the brief to any testimony in support of that statement. The only direct evidence in the record on that subject is that the insured did not suffer bodily injury. There is no evidence that he fell or was thrown against or was struck by or came in contact with any foreign object. Appellant reviewed in detail all of the evidence in this case on that subject on page

9 of its opening brief. Furthermore, the insured did not complain of any bodily injury (R.T. 163) and his examining physician found no evidence of any injury either to the insured's body or brain (R.T. 165). The insured's attending physician testified that the "psychic trauma" which the insured suffered was something "within the mind" and had to do with his thinking rather than any part of his body or brain (R.T. 164-165). The expert psychiatrist, Dr. Strand, called by plaintiff also testified "that psychic trauma would represent a stress reaction on the part of the individual initially at the mind or mental level." (R.T. 272)

The policy in this action obligates the insurer only for "loss resulting directly and independently of all other causes" from "bodily injury" which is "caused by accident." The policy by its terms does not insure against loss caused by "psychic trauma" or "shock" or any loss which is induced by processes within the "mind" or as a result of any imbalance of the thinking processes.

ARGUMENTS

(1) Construction of Insurance Contract

Supplemental to the authorities cited in Appellant's Opening Brief on the matter of construction of an insurance contract, attention is invited to the language of the Supreme Court of the State of Washington in *Evans v. Metropolitan Life Insurance Company*, 26 Wn.2d 594, 174 P.2d 961 (1946). At page 604 the Court said

"1. It is self-evident that (1) an insurance policy is merely a written contract between an insurer and an insured; (2) courts cannot rule out of the con-

tract any language which the parties thereto have put into it; (3) a court is not at liberty to revise a contract under the theory of construing it; (4) neither abstract justice, nor any rule of construction, justifies the creation of a contract for the parties which they did not make themselves, or the imposition upon one party to a contract of an obligation not therein by him assumed. The words and terms as used in the contracts must be construed in their ordinary and popular sense." (Emphasis supplied)

(2) Reply to Appellee's Arguments

In referring to the Texas case Pan American Life Insurance Company v. Andrews, 340 S.W.2d 78 (1960), Appellee attempts to distinguish it on the basis of differences in language in the insuring provisions. The two policies which were before the Court in the Andrews case do contain some language not included in the policy at bar. The two Andrews policies required that the "bodily injury" must have been occasioned by "external, violent and accidental means;" whereas, in the policy at bar it is required only that the "bodily injury" be caused by "accident." The two Andrews policies each contain specific exclusions in instances of "bodily injury" "of which there is no visible contusion or wound on the body, except in the case of drowning or internal injuries revealed by autopsy." Thus, even under the two policies in the Andrews case, recovery could be effected even in the absence of visible contusions or wounds on the body if death resulted from drowning or internal injuries disclosed by autopsy. In commenting on the exclusion provisions, the Texas Court stated with respect to the autopsy requirement, at page 792 of the opinion:

"(4) The provision for autopsy is to afford the opportunity for establishing the fact that death was caused by a physical force where there was no outward manifestation on the body of that force. Otherwise no recovery could be had for an accidental death caused by taking into the body poisonous substances or for other injuries sometimes caused to internal organs of the body or by external physical force without any visible contusion or wound. The provision for autopsy was not to set up a new category of injuries such as mental shock, but simply as a means of determining that death did result from some physical and violent force." (Emphasis supplied)

Notwithstanding the differences in the wording in the Andrews' policies, from that of the policy at bar, the underlying reasons for the conclusions reached in the Andrews case are certainly applicable to our present case. Andrews' death did not result from "bodily injury" caused "directly and independently of all other causes" from external, violent and accidental means—it resulted from an intervening mental or psychic condition which was the same type of psychic condition or mental reaction which intervened and was the direct cause of the death of Mr. Thompson in the case at bar.

CONCLUSION

Based on the record in this case and the authorities cited, Appellant submits that the judgment of the trial court should be reversed.

Respectfully submitted,

W. PAUL UHLMANN
Of Attorneys for Appellant

CERTIFICATE

I hereby certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and, that in my opinion the foregoing brief is in full compliance with those rules.

Respectfully submitted,

W. Paul Uhlmann
Of Attorneys for Appellant

No. 21002 √
IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Estate of Jesse E. Caton, dba CATON PRODUCTION MACHINES,

Appellant,

US.

PASADENA FINANCE COMPANY, a California corporation, et al.,

Appellee.

APPELLANT'S OPENING BRIEF.

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IN THE

United States Court of Appeals

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RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Estate of Jesse E. Caton, dba CATON PRODUCTION MACHINES,

Appellant,

US.

PASADENA FINANCE COMPANY, a California corporation, et al.,

Appellee.

APPELLANT'S OPENING BRIEF.

Jurisdictional Basis.

This is an appeal from a final judgment made and entered in the United States District Court for the Southern District of California, Central Division, and this appeal is prosecuted in accordance with the provisions of Rule 72 et seq. of the Federal Rules of Civil Procedure in the United States District Court.

On June 11, 1962, Jesse E. Caton doing business as Caton Production Machines filed a voluntary petition in bankruptcy.

On February 16, 1966, the Trustee in Bankruptcy, Appellant herein, filed a Complaint for Recovery of a Preferential Transfer. [Clk. Tr. p. 2.]

On March 24, 1966, Pasadena Finance Company, Appellee, filed a Notice of Motion and Motion to Dismiss And For Summary Judgment under Rules 12 and 56 of the F.R.C.P. [Clk. Tr. p. 6.]

On March 24, 1966, the Appellee filed in support of said Motion the Affidavits of Lyle A. Adrianse and W. M. Darnell. [Clk. Tr. pp. 12 and 38.]

On April 6, 1966, Appellant filed its Statement of Genuine Issues. [Clk. Tr. p. 43.]

On April 11, 1966 the Motion for Summary Judgment was heard before the Honorable William M. Byrne, Presiding Judge of the United States District Court. Judge Byrne ruled from the bench in favor of Appellees.

On April 11, 1966 Findings of Fact, Conclusion of Law and Summary Judgment of Dismissal was filed. [Clk. Tr. pp. 51 and 58.]

On April 12, 1966 the Summary Judgment of Dismissal was entered. [Clk. Tr. p. 58.]

On April 14, 1966 Notice of Signing and Filing of Judgment was filed. [Clk. Tr. p. 61.]

On April 20, 1966 Notice of Appeal was filed by Appellant, together with Statement of Points on Appeal. [Clk. Tr. pp. 63 and 64.]

Statement of the Case.

On August 20, 1964 at 10:00 A.M. the United States Machinery Company entered into a transaction with the bankrupt, Jesse Caton, doing business as Caton Production Machines, by which United States Machinery purported to buy from, and then immediately lease back to, the bankrupt, all of his machinery, equipment, vehicles and other assets. This transaction was

handled through an escrow at the First Western Bank. There was an attempt by both United States Machinery Company and the Bank to comply with the provisions of Section 3440(h) of the Civil Code of the State of California. However, the Notice of Intended Transfer and Lease Back was not recorded until August 10, 1964, at 3:30 P.M.

Immediately, thereafter United States Machinery Company sold and/or assigned all of its right to the machinery, equipment, vehicles and other assets and the lease thereon to Pasadena Finance Company, the Appellee. The bankrupt became delinquent on his lease payments and subsequently, and on May 26 and 27, 1966 all of the leased assets were repossessed by Pasadena Finance Company.

On June 11, 1965 Jesse Caton filed a voluntary petition in bankruptcy. The trustee brought suit against Pasadena Finance Company on the theory that the sale and leaseback, were conclusively fraudulent as to creditors because the requisite ten days notice was not given before the sale; that therefore Pasadena Finance Company had no valid security interest in the assets, but was simply an unsecured creditor; and that the repossession by them of the assets within four months of bankruptcy constituted nothing more than a preferential transfer voidable pursuant to Section 60 of the Bankruptcy Act.

At the hearing upon the Motion for Summary Judgment, both sides restricted argument to the issue of the ten day notice. Appellant concedes that if the Notice of Intended Transfer and Leaseback was recorded "at least 10 days before the date of transfer and leaseback", then Appellee had a valid security and the dismissal of the complaint was proper.

ARGUMENT.

POINT ONE.

The Notice of Intended Transfer and Lease Back Was Not Recorded at Least 10 Days Before the Date of Transfer and Lease Back.

It is admitted that the Notice was recorded August 10, 1964 at 3:30 o'clock P.M. The sale and leaseback transaction was held August 20, 1964 at 10:00 A.M. Section 3440(h) reads in part as follows:

"Every transfer of personal property and every lien on personal property made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred, is conclusively presumed fraudulent and void as against the transferor's creditors while he remains in possession and the successors in interest of those creditors, and as against any person on whom the transferor's estate devolves in trust for the benefit of others than the transferor and as against purchasers or encumbrances in good faith subsequent to the transfer."

EXCEPTIONS.

- (h) A transfer of personal property if:
- (1) Said personal property is leased back to the transferor immediately following said transfer.
- (2) The transferor (lessee) or the transferee (lessor) records at least 10 days before the date of the transfer and leaseback in the office of the county recorder in the county or counties in which the personal property is situated a notice of the

intended transfer and leaseback which states the name and address of the transferor (lessee) and the transferee (lessor).

This section was added to Section 3440 of the Civil Code in 1959. Appellant has been able to find no California cases interpreting the time requirement of this section. However, it is clear from the similarity in language, and, indeed, almost identical wording of the notice section that the legislature intended to grant to all creditors in a sale and leaseback transaction, the protection afforded to creditors of only a restricted class of debtors under California Civil Code Section 3440.1 otherwise known as the Bulk Sales Act. (Now repealed by Stats. 1965, Ch. 819, pp. 200, 39, 23.)

Section 3440.1 was once embodied in Section 3440, but became a separate section in 1951. The second paragraph of Section 3440.1 declares any bulk sale or transfer by certain types of debtors conclusively fraudulent as to their creditors unless the parties:

(a) Records at least 10 days before the consummation of the sale, transfer, assignment, or mortgage, in the office of the county recorder in the county or counties in which the stock in trade, fixtures, or equipment are situated, a notice of the intended sale, transfer, assignment, or mortgage...

However, Section 3440.1 is more detailed and specific than Section 3440(h). The fifth paragraph states:

"The sale shall not occur within 10 days from the recordation of the notice".

This court has interpreted purpose of the notice provision of Section 3440.1 in *Bumb v. United States*, 276 F. 2d 729, 734 (1960).

The object of the statute is:

(1) to furnish creditors of the intended mortgagor the period of at least 10 days within which to levy attachment or execution on the property to be mortgaged and (2) to garnish or levy on the proceeds of the mortgage in the event provision is not made for the payment of the claims presented. (Emphasis added.)

If the 10 day notice requirement is the same for both Sections 3440(h) and 3440.1 of the Civil Code, it is clear in the case at hand that the required 10 day notice was not given. The creditors of the bankrupt here did not have at least 10 days to levy upon the bankrupt's assets. The bankrupt's creditors had only nine days in which to protect themselves.

POINT TWO.

The Ordinary Rule for Computing Time Does Not Apply to Section 3440(h) of the Civil Code of California.

Several statutes state the general rule for computing time.

The time in which any act provided by law is to be done is computed by excluding the first day and including the last, unless the last day is a holiday, and then it is also excluded.

California Civil Code, Section 10.

California Code of Civil Procedure, Section 12.

California Education Code, Section 9.

California Government Code, Section 6800.

Note that the language of those sections refers only to computing the time within which an act must be done. Section 3440(h) requires the expiration of a ten day period, before the act must be done. In other words, the sale and leaseback transaction must take place outside of the ten day period and not within it.

This important distinction was made in the case of *Hutchins v. County Clerk*, 140 Cal. App. 348, 349, 35 P. 2d 563 (1934).

Now there is a difference in law between the meaning of the words "within" and "prior". If you have to do a thing before a certain day that day is not included; in other words, if you have to do a certain thing before the twenty-fourth day of June, June 24th is not included, because it must be before.

It is clear that Civil Code Section 3440.1 did require a different computation of time by the express command;

The sale shall not occur within 10 days from the recordation of the notice.

If the parties had attempted a Bulk Sale instead of a Sale and Leaseback, the sale on August 20, 1964 would have violated Section 3440.1, since under the general rule, August 20, 1964 would be within 10 days of August 10, 1964. There is no reason to believe the legislature intended a different procedure or a different rule should apply to Section 3440(h).

In the recent case of the City of Pleasanton v. Bryant, 63 Cal. 2d 643, 47 Cal. Rptr. 807, 408 P. 2d 1351 (1965), the Supreme Court of California construed a statute, very similar to Section 3440(h) to mean a certain period of time had to expire after the filing

of a notice before another notice could be filed. Government Code Section 34302.5 stated in part:

For a period of 90 days after the filing of such notice of intention to incorporate (a) no other notice of intention shall be filed...

On January 18, 1963 the first notice was filed. On April 18, 1963 a second notice was filed. The Court held the second notice was filed one day prematurely. In noting that the authorities in California fell into two classes namely: (1) Those dealing with the question of whether a given act was done too late and (2) Those in which the question is whether a given act was done too early, the court stated the rule for computation was the same. However, in the second line of cases, the court used the general rule to compute the time *interval* that had to expire before the act could be done.

By reason of the foregoing Appellant believes the judgment below should be reversed.

Dated Dec. 12, 1966.

Respectfully submitted,

RICHARD M. MONEYMAKER, Attorney for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD M. MONEYMAKER



No. 21002 IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Estate of Jesse E. Caton, dba CATON PRODUCTION MACHINES,

Appellant,

US.

Pasadena Finance Company, a California corporation, et al.,

Appellee.

APPELLEE'S BRIEF.

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DEC 3 0 1966

WM. B. LUCK, CLERK



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Appellee.

APPELLEE'S BRIEF.

Appellee, Pasadena Finance Company, upon motion pursuant to Rules 12 and 56 of the Federal Rules of Civil Procedure, was granted a summary judgment of dismissal in an action by the Appellant Trustee in Bankruptcy of Jesse E. Caton, dba Caton Production Machines (hereinafter called Caton).

Richard R. Clements, the Trustee Appellant, brought this action under Sections 60 and 70e of the Bankruptcy Act (Secs. 96 and 110e of Title 11, U.S.C.A.) to recover certain machinery, vehicles and equipment which Caton had sold to United States Machinery Company and immediately leased back from such company under a written lease.

United States Machinery Company thereupon sold its rights as lessor to Appellee Pasadena Finance Company. Later, on May 26, 1965, Caton surrendered the machinery and equipment up to Appellee while Caton was in default in making payments under the lease. Within four months after surrendering such property up to Appellee, Caton filed a voluntary petition in bankruptcy.

Appellee's motion for a summary judgment was supported by an affidavit of its Vice President, Lyle Adrianse, which showed that the leasing transaction and the transfer of the lease to Appellee had been handled through an escrow at First Western Bank and Trust Company, which bank handled the notice of sale. Nothing in such affidavit is opposed to the allegations in the Complaint. It merely sets forth, as exhibits, the copies of the crucial writings, and Appellant never made any attempt to challenge any statements in the Adrianse affidavit, so the case involves nothing but questions of law as to the interpretation of Section 3440(h)(2) of the Civil Code.

There is no basis for any liability on the part of Appellee, and the escrow instructions containing the tenday notice, as required by Section 3440(h)(2), do not impose any liability upon Appellee. In fact, if there was any liability on the part of anyone, it would be on the part of First Western Bank and Trust Company, the party who acted as escrow agent in the transaction and who recorded the Notice of Transfer and Lease Back.

Statement of the Case.

The question in this case resolves into whether the notice under Section 3440(h)(2), which the escrow agent gave, was sufficient, or whether the notice was one

day short of the statutory requirement. If it was short, then did this invalidate the Appellee's rights under the lease contract? If the ten-day notice was timely given, Appellee acquired its vested rights which entitled it to repossess the equipment within the four-month period prior to bankruptcy.

If the notice was too short under Section 3440(h)(2), then Appellant says that the repossession by Appellee of the equipment, under the terms of the lease, would have constituted a voidable preference. Appellant also contends that a full period of ten days' notice was not provided for by First Western Bank and Trust Company, so Appellant claims that the notice was too short.

On August 7, 1964, the transaction was implemented by escrow instructions signed by Appellee and the United States Machinery Company. [Ex. 1 to Adrianse Affidavit.]

Exhibit 3 to the Adrianse affidavit, designated as "Notice of Intended Sale", shows a recording time of 3:30 P.M. on August 10, 1964. This notice was executed and recorded pursuant to Section 3440.1 of the Civil Code, and Appellant's attack does not seem to be predicated upon any defects regarding this notice.

The asserted defect in timing relates to the "Notice of Intended Transfer and Leaseback", attached to the Adrianse affidavit as Exhibit 4 which shows a recording date of 3:30 P.M. on August 10, 1964.

We do not believe that this transaction was of the type which required compliance with the notice requirements of Section 3440.1, since it did not involve a sale or assignment of a stock in trade. It related to a transfer of precision machinery in a machine shop.

This is not a matter to which we need to devote further time, because it is conceded that the provisions of Section 3440(h)(2) do apply, and the notice required with respect to a sale and lease back under those provisions would govern in any event. It should be added that the time requirements of Sections 3440.1 and 3440(h)(2) are identical in any event, so that if the period of notice was insufficient under one section, it could likewise be insufficient under the other.

Section 3440(h)(2) is a part of a comprehensive law dealing with various transfers. Section 3440 begins by declaring transfers to be void when there is no actual physical change of possession. The provisions of subdivisions (h)(2) cover an exception to this requirement that there be a physical change of possession where the transferor immediately or concurrently leases back the machinery and equipment from the transferee. Such provisions cover a transaction which is, in effect, a financing transaction, in that the owner of the equipment transfers the equipment to another party which, in turn, leases the equipment back to the owner on a monthly rental basis. These monthly rental payments are periodically receved in payment of the moneys for which the owner originally sold the equipment to the financing company. In other words, the transaction, by its very nature, was never intended to involve a transfer of physical possession to anyone. It merely made possible an arrangement whereby an owner received money for the purported sale of equipment and then paid back such money on a monthly basis while such owner continued to possess and utilize the equipment in the owner's plant.

The bill of sale to the machinery and equipment is dated August 20, 1964, and was concededly delivered by

the escrow agent to the United States Machinery Company at that time. [Ex. 5 to Adrianse affidavit.] At the same time, the United States Machinery Company caused all of this machinery to be leased back to Caton [Ex. 7 to Adrianse affidavit], and also assigned its lessor's interest therein to Appellee. [Ex. 8 to Adrianse affidavit.]

Simultaneously, the United States Machinery Company signed a bill of sale assigning its ownership in the machinery to Appellee. [Ex. 6 to Adrianse affidavit.]

It is this sale and lease back transaction which was initiated by the recording of the Notice of Intended Transfer and Leaseback, recorded on August 10, 1964, at 3:30 P.M., and consummated by the delivery of the documents described in the two preceding paragraphs which Appellant is now attacking. Appellant argues that ten days did not elapse between 3:30 P.M., August 10th, and 10:00 A.M., August 20th, the date of the consummation of the escrow [Adrianse affidavit, Para. 12, p. 4], so from this assumption, Appellant asserts that Appellee had no valid ownership in, or rights to accept the return of, the machinery within four months of Caton's bankruptcy on June 11, 1965, bearing in mind that it was on May 26, 1965, when Appellee received the return of the machinery. [Complaint, p. 3, line 1.]

Appellee contends that a portion of a day is legally considered as a full day and that the ten-day notice requirement was complied with, so that Appellee was not a mere general creditor at the time it re-acquired possession of the machinery on May 26, 1965. On the contrary, it had a valid right to repossess the machinery by reason of Caton's defaults in the payment of rentals under the lease back.

There is one other possible matter which should be mentioned, and this is that, at the time the machinery was repossessed, there was no equity over and above the amount still owed Appellee under the lease. Neither did Appellant proceed on any such basis or that Appellant wished to have time to endeavor to dispose of the machinery for more than the unpaid rental to Appellee. In spite of this and as a precautionary measure, Appellee filed an affidavit of a W. M. Darnell, an expert on machinery values, which shows the value of the machinery to be less than the balance due under the socalled lease back. The affidavit of W. M. Darnell shows that the market value of the equipment at the time of its repossession by Pasadena Finance Company was \$16,156.00, and the affidavit of Lyle Adrianse shows that at the time of its repossession, there was unpaid under the lease back the sum of \$25,906.00, resulting in a deficiency of approximately \$12,000.00.

In this connection, Appellee cites 8A Corpus Juris Secundum, Section 220(5) at pages 120 and 121 (Note 67), to the effect that a valid lien creditor who repossesses property during the four-month period before bankruptcy is not subject to attack by the trustee, unless there has been a substantial excess in value of the equipment which was repossessed over the amount of the indebtedness secured thereby. Unless there is such substantial difference, there is no diminution of the estate which the trustee can attack. On this same point, see Collier Bankruptcy Manual, 2d Ed., pages 522 and 523, Subsections (2) and (3).

With the foregoing facts, it becomes merely a matter of construing the provisions of Section 3440(h)(2).

ARGUMENT.

I.

The Law of the State Governs the Construction of Section 3440(h)(2).

See: Erie R. Co. v. Thompkins, 304 U.S. 64, 58 S. Ct. 817.

It is true that the provisions of the Bankruptcy Act may govern matters relating to time when fixed by a bankruptcy statute, such as the four-month period within which to attack a voidable transfer, and time relating to a final discharge.

Where a state statute is being applied, it is construed in accordance with the state law.

See:

Bankruptcy Act, Section 31 (Sec. 54, Title 11, U.S.C.A.); and

Rule 6a, Federal Rules of Civil Procedure.

On the other hand, the construction of a state law, such as Section 3440(h)(2), is governed by state law.

See:

In re Aerocolor, Inc. (U.S.D.C. S.D. Cal. C.D.), 236 Fed. Supp. 84; and

Edwards v. McCullough (U.S.D.C. W.D. Ky.), 114 Fed. Supp. 766.

II.

Section 3440(h)(2) of the Civil Code Was Designed to Cover a Sale and Lease Back Such as the One Involved in This Case.

Appellee will now discuss the law which shows that proper notice of such sale and lease back was given, so that there is no liability on which Appellant is entitled to recover against anyone. This is not only demonstrated by the allegations in Appellant's Complaint, which show that the notice required by Section 3440-(h)(2) was recorded on August 10, 1964, and that the assignment and lease back took place on August 20, 1964, but it is even more specifically shown from the documents relating to the escrow, handled at First Western Bank and Trust Company, which are attached to the Affidavit of Lyle A. Adrianse, an officer of Appellee, Pasadena Finance Company. These documents show conclusively that the notice was recorded by First Western Bank and Trust Company on August 10, 1964, and that the transaction took place on August 20th, so that there was a ten-day period which transpired within the meaning and requirements of Section 3440(h)(2).

Clearly, the above statute applies, since the transaction was one in which the bankrupt assigned and transferred all of the machinery and equipment to the United States Machinery Company, which, in turn, entered into a written lease under which it leased back to the bankrupt all such machinery and equipment, and in the same escrow, United States Machinery Company assigned its rights, as lessor under the lease, together with all of its rights and ownership in and to the machinery and equipment, to Appellee. It is this type of transaction, wherein possession of the machinery and equipment

never leaves the bankrupt, that Section 3440(h)(2) is designed to cover, as Subd. (2) states:

"The transferor (lessee) or the transferee (lessor) records at least 10 days before the date of the transfer and leaseback in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the intended transfer and leaseback which states the name and address of the transferor (lessee) and transferee (lessor). The notice shall contain a general statement of the character of the personal property intended to be transferred and leased back, and show the date when and place where the transaction is to be consummated."

III.

The Notice Required by the Statute in Connection With the Sale and Lease Back Was Valid.

The Escrow Instructions [Ex. 1 to Adrianse affidavit] were dated August 7, 1964, and the directions which the two parties to such escrow, that is, the bankrupt and United States Machinery Company, gave to First Western Bank and Trust Company, the escrow agent, were in the language of Section 3440(h)(2) of the Civil Code, in that the said escrow agent was instructed to record "at least ten (10) days before date specified for sale" a Notice of Intended Transfer and Leaseback. This Notice [Ex. 4 to Adrianse affidavit] shows the County Recorder's recording stamp of August 10, 1964, at the hour of 3:30 o'clock P.M. This Notice also shows that the date specified therein for closing the escrow was August 20, 1964, and it is conceded that the escrow was closed and the bill of sale and

lease back were delivered by the escrow agent on August 20, 1964, to the parties entitled thereto.

All of the cases dealing with language, such as that contained in Section 3440(h)(2) of the Civil Code, have construed it to require that the date on which the notice was recorded is excluded in computing the ten-day period, and the date of the delivery or closing of the escrow may be included in computing such ten-day period. The rule is stated in *Section 10* of the California Civil Code as follows:

"Computation of time. The time in which any act provided by law is to be done is computed by excluding the first day and including the last, unless the last is a holiday, and then it is also excluded."

The same rule is stated in 47 Cal. Jur. 2d (Time) under Section 10 at page 670 as follows:

"The general rule is that fractions of a day are not considered in the computation of time, and that the day on which an act is done must be either excluded or included in its entirety. Accordingly, where the law fixes the time within which an act is to be done, all of the last day of that period is within the time. Any other method computation would require the keeping of an accurate account of the exact hour, minute, and second of the occurrence of the act to be timed, would produce endless confusion and strife, and would prove impolitic, if not wholly impracticable."

It is further stated under *Section 11* of 47 Cal. Jur. 2d at page 672 as follows:

"It is provided by law that the time within which any act provided by law is to be done is computed by excluding the first day and including the last, unless the last is a holiday, and then it also is excluded. This is the general or ordinary rule for the computation of time. Before a given case will be deemed to come within an exception, the intention must be clearly expressed to provide a different method of computation."

The above rules are not restricted merely to procedure but are applicable to any act required by law, unless the particular statute specifically requires the application of a different rule.

See:

47 Cal. Jur. 2d (Time), Section 12, p. 673.

For decisions holding that, in counting time, the first day is excluded and the last day is included, see:

Union Oil Co. v. Domengeaux, 30 Cal. App. 2d 266 at 272 and 273;

Reichardt v. Reichardt, 186 Cal. App. 2d 808 and 809 and 810; and

Ley v. Dominguez, 212 Cal. 587 at 594.

Each of the above cases also states the rule that in order to apply a different method of computing time, the intention of the statute involved must be clearly shown.

No authority sustains Appellant's position that the required ten-day period of notice did not expire, as required by the statute.

Appellant relies upon a single decision, which is a typical example of applying another method of counting time, because the specific statute involved required this. That case is *City of Pleasanton v. Bryant*, 63 A.C. No. 23,673. In such case, the court was inter-

preting Section 34302.6 of the Government Code involving incorporation of municipalities. The statute, in specifying time, used the words "For a period of 90 days after the filing of such notice of intention (to incorporate)". The court, in explaining its decision, said at page 676:

"The first notice was filed on January 18, 1963; and the period of 90 days after January 18 included April 18, 1963. Thus the second notice of intention, filed April 18, 1963, was one day premature. This conclusion is supported by Municipal Imp. Co. v. Thompson (1927) 201 Cal. 629 (258 P. 955), relied upon by the Dublin Group. The language of the statute there considered differed from that now before us, but the court noted (p. 632) that if that statute had 'read that the objections should be heard at least "twenty days after the posting of notices," '(italics added), then the first day (September 25) would be excluded and the last day (October 15) included, the prescribed 20day waiting period would intervene, and the hearing held October 15 would have been one day early. Thompson further declares that 'The law takes no notice of fractions of a day. Any fraction of a day is deemed a day unless in a particular case it is necessary to ascertain the relative order of occurrences on the same day.' (See also Reichardt v. Riechardt (1960) 186 Cal. App. 2d 808, 810 (9 Cal. Rptr. 225).)"

In the above-quoted language, the court cites with approval the *Reichardt* case, *supra*, which we have already hereinabove cited in support of the rule applicable to this type of transaction.

IV.

Even Though the Documents Should Not Have Been Delivered Until a Day Later, Appellant Has Shown No Prejudice Entitling Appellant to Attach the Sale and Lease Back Which Was Supported by an Adequate Consideration.

There is no contention by Appellant that the moneys paid through the escrow on August 20, 1964, were not an adequate consideration. Furthermore, there is no contention that at the time of such sale and lease back, there was any intention to dispose of the machinery and equipment for less than its reasonable value. Likewise, Appellant is not contending that Appellant actually suffered any prejudice by reason of the papers being delivered on August 20, 1964, the date specified in the Notice of Intended Transfer and Leaseback which was recorded August 10, 1964 [Ex. 4 to Adrianse affidavit].

In the case of *Aerocolor*, *Inc.* (D.C. Cal. S.D. C.D. 1964) 236 Fed. Supp. 84, the court, in holding the transfer to be valid, said at page 87:

"The Referee found that the consideration for the chattel mortgages and the delivery of the chattel mortgages were not in accordance with the provisions of Section 3440.1 of the California Civil Code in that the mortgages were recorded 15 minutes prior to the time designated in the notice of intention to mortgage.

The record does not reveal just when the consideration was paid or just when the chattel mortgages were actually delivered. All it does show is that the challetel mortgages were recorded 15 minutes before the time designated in the notice.

"In the absence of any showing of prejudice on the part of any creditor, I conclude that there has been a substantial compliance with Section 3440.1 of the California Code. In the absence of a further showing as to the time at which the consideration changed hands, the presumption of validity should support this holding. The object of this Section in the Civil Code is to furnish creditors of the intended mortgagor a period of at least ten days within which to levy attachment or execution on the property to be mortgaged and to garnishee or levy on the proceeds of the mortgage in the event payment is not made on the claims presented. There is no showing that the premature recordation of the chattel mortgages has in any way frustrated the object of the statute or prejudiced the rights of the creditors * * *."

In the above decision, the court did not discuss or go into the question of measuring periods of time. It was not concerned with how time is counted, because the question there was whether the recording of the documents 15 minutes prior to the time stated in the notice invalidated the transaction. In other words, it was a question whether failure to record exactly on the hour specified in the notice invalidated the transaction, and the court held that this did not.

For other cases indicating that a transaction, in the absence of prejudice, would not be set aside even though there had not been strict compliance with Section 3440 (h)(2), see:

In re Lundgren Wood Products, 198 Fed. Supp. 908; and

Dersch v. Thomas, 138 Cal. App. Supp. 785 at 789.

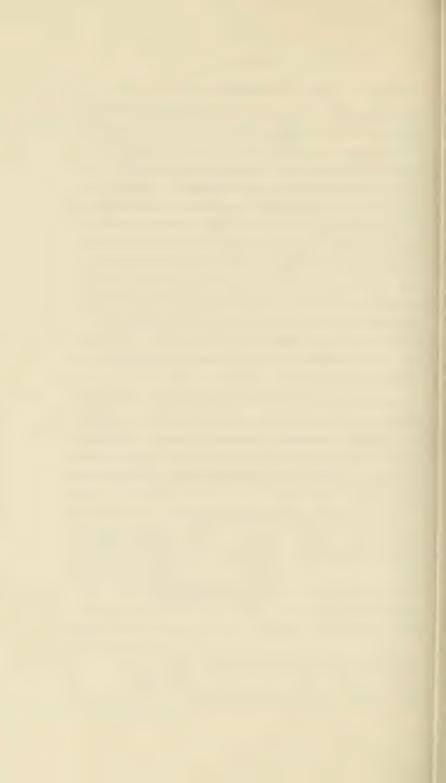
Conclusion.

The burden of attacking the validity of the sale and lease back has always been on Appellant. In spite of his failure to sustain such burden, Appellant has shown no grounds upon which the recovery by Appellee of the equipment could constitute a voidable preference. On the contrary, Appellant has disregarded the wealth of statutory interpretation in this field and has endeavored to utilize a decision which has utterly nothing to do with liens of the type involved herein or with the measurement of time for giving notice, as required by the law relating thereto. The fact that Appellant has been forced to go so far afield and attempt to rely upon the *City of Pleasanton v. Bryant, supra,* is indicative of the destitution of Appellant's position in this case.

We believe that the Court should put an end to this litigation by affirming the decree granting the motion for summary judgment, and by ruling in accordance with the numerous interpretations which have existed with respect to the measurement of time on these types of matters.

Respectfully submitted,

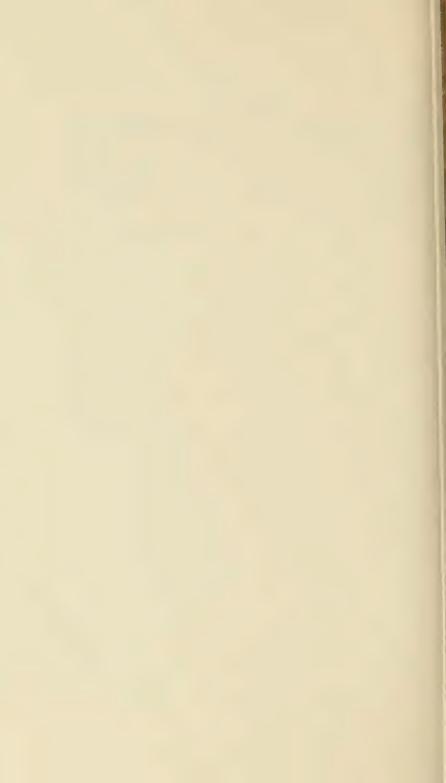
McLaughlin & McLaughlin, By James A. McLaughlin, Attorneys for Appellee, Pasadena Finance Company.



Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES A. McLAUGHLIN



No. 21002 IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS,

Appellants,

US.

PASADENA FINANCE COMPANY, a California corporation, et al.,

Appellee.

APPELLANT'S REPLY BRIEF.

RICHARD M. MONEYMAKER, 650 South Spring Street, Los Angeles, Calif. 90014, Attorney for Appellant.



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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS,

Appellants,

US.

PASADENA FINANCE COMPANY, a California corporation, et al.,

Appellee.

APPELLANT'S REPLY BRIEF.

Appellant's Statement of Case.

There appears to be no disagreement as to the material facts as set forth in appellant's and appellee's briefs.

ARGUMENT.

Points I and II of Appellant's Brief and Points II and III of Appellee's brief present both sides of the case and Appellant will not reiterate any points previously made.

The Court should note however, that the three (3) cases cited by Appellee, to wit:

Union Oil Co. v. Domenyeaux, 30 Cal. App. 2d 266, 272-273 (1939);

Reichardt v. Reichardt, 186 Cal. App. 2d 808, 809-810 (1960);

Ley v. Dominguez, 212 Cal. 587 at 594 (1931).

are all case interpreting statutes which require an act to be done within a certain time period.

In Union Oil Co. v. Domengeaux (supra), the statute required an action to be brought "within one hundred eighty days". In Reichardt v. Reichardt (supra) the issue was whether an application for modification of an alimony award was filed within three years, of the entry of award. In Ley v. Dominguez (supra) the issue was whether certain referendum petitions were filed within 30 days of the date of the publication of a city ordinance.

Appellee has cited no case interpreting a statute which requires a certain minimum time period to expire before an act may be done.

I.

If the Sale and Lease Back Transaction Occurred One Day Prematurely Then the Security Interest of Appellee Was Not Perfected Until the Machinery Was Repossessed.

(a) Appellee's Cases Are Not Applicable.

In Point IV of the Reply Brief, the Appellee is raising a point not mentioned in Appellant's Opening Brief. Discussion was omitted because the District Judge based his decision solely upon the issue of the ten day notice and stated that other grounds were not necessary to sustain the Motion To Dismiss the Complaint.

The Appellee relies heavily upon the language in the case of *In re Aerocolor*, *Inc.*, 236 Fed. Supp. 94 (D.C. 1964). That case was reversed August 3, 1965 by this Court, under the heading, *Martin v. Crocker-Citisen's National Bank*, 349 F. 2d 580 (1965), and is no longer the law.

Similarly Appellee's citations of *In re Lundgren Wood Products*, 198 Fed. Supp. 908 (1961) and *Dersch v. Thomas*, 138 Cal. App. Supp. 785 (1934), are inapplicable since those cases deal with entirely different facts, and subsection (h) of Civil Code Section 3440 is not even involved. More importantly, Section 60a(2) and (3) of the Bankruptcy Act was not involved.

(b) Appellant Need Not Prove the Existence of an Actual Creditor.

Appellee's argument that Appellant must prove actual prejudice to a creditor to invalidate the sale and lease-back transaction, demonstrates a misconception of the theory of Appellant's case. Appellant has sought to recover the value of the repossessed property under the theory that repossession by the Appellee within four months of bankruptcy is a preferential transfer voidable pursuant to Section 60(a) of the Federal Bankruptcy Act (Title II, U.S.C. Sec. 96). Section 60(a)-(2) provides in part:

"... a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee..."

and Section 60(a)(3) provides in part:

"The provisions of paragraph (2) shall apply whether or not there are or were creditors who might have obtained such liens upon the property other than real property..."

These sections were passed in 1938 to do away with the necessity of the trustee proving the existence of an actual creditor, in determining whether a lien is perfected. The trustee must prove the existence of an actual creditor to attack a transfer only pursuant to Section 70(e) of the Bankruptcy Act (Title II, U.S.C. 110 e).

A transfer may not be voidable by a trustee pursuant to Section 70(e) because of the non-existence of actual creditor, and still be unperfected within the meaning of Section 60 a(2) and (3).

Miller v. Sulmeyer, 263 F. 2d 513 (9 C. A. 1959);

Collier on Bankruptcy, Vol. 3, Sec. 60.38, pp. 952-953.

(c) Actual Prejudice Is Immaterial.

Appellee apparently agrees that the purpose of Civil Code Sections 3440h(2) and 3440.1 are the same (Appellee's Br. p. 4, first para.).

This Court in construing the purpose and effect of a failure to follow the prescribed procedure in Civil Code Section 3440.1, stated the following in *Bumb v. United States*, 276 F. 2d 729 (1960).

Appellee further argues that since it does not appear in the record that any of the creditors of Dinsmore Equipment Company appeared at the office of the Small Business Administration on November 21, 1956, it must be assumed that none of them was misled by the manner in which the consideration was paid. In our view such latter fact is immaterial. Page 735 (emphasis added).

Conclusion.

The failure to give the requisite 10 day notice of Civil Code Section 3440a(2) rendered the sale and leaseback security arrangement unperfected within the meaning of Section 60(a)(2) and (3) of the Bankruptcy Act. The security interest of the Pasadena Finance Company was therefore not perfected until it repossessed the bankrupt's equipment and goods within the four months immediately preceding bankruptcy and thus appellant should be allowed to establish a preferential transfer voidable as to the general creditors of the bankrupt estate.

Respectfully submitted,

RICHARD M. MONEYMAKER,

Attorney for Appellant.



Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

R. M. Moneymaker



No. 21003 V

United States Court of Appeals

FOR THE NINTH CIRCUIT

Pasadena Investment Company and William J. Clark,

Appellants,

vs.

MARGUERITE J. WEAVER,

Appellee.

APPELLANTS' OPENING BRIEF.

FILED

SEP 26 1966

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vestment Co. and William J. Clark.



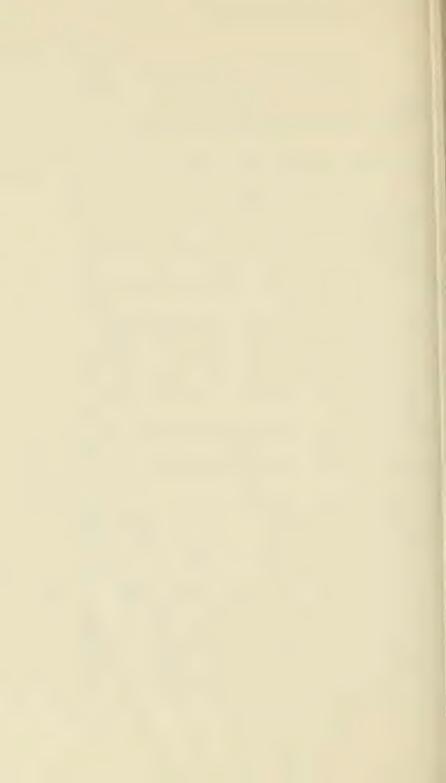
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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Pasadena Investment Company and William J. Clark,

Appellants,

US.

MARGUERITE J. WEAVER,

Appellee.

APPELLANTS' OPENING BRIEF.

Statement of Pleadings and Facts Disclosing Jurisdiction.

Appellee, Marguerite J. Weaver, a widow, filed a petition for an arrangement under Chapter XI of the Bankruptcy Act (Secs. 707-799, Title 11, U.S.C.A.). No Receiver was appointed, and it will be shown that there was nothing which a Receiver could have taken custody of, in any event, because her primary asset was a fifty-five acre ranch near Tulare, California, which was under a term lease to a tenant and also a term sub-lease to a sub-tenant. [R.T. p. 57, line 26, to p. 58, line 1.]

After filing the above proceedings, the Appellee debtor, on July 7, 1965, filed a petition for an order restraining a trust deed sale under a trust deed, wherein Appellant Pasadena Investment Co. was beneficiary, Title Insurance and Trust Company was trustee, and Appellee and her deceased husband were trustors, securing a \$51,000.00 promissory note. [T. p. 61, lines 5-25.] Appellant William J. Clark was joined as a holder of such note, it being conceded that he acquired his ownership after it became due. [T. p. 62, line 26, to p. 63, line 20.]

The Debtor's petition did not specify the jurisdictional grounds for the relief sought, but it proceeded upon the ground that a restraint of the trust deed was essential to prevent the loss of the main asset of the Debtor's estate, and on the ground that the trust deed had been procured by fraud on the part of Pasadena Investment Co.

At the inception of the hearing before the Referee (The Honorable Donald R. Franson), the question of his jurisdiction to proceed was argued at length by Appellants through their then attorneys, even to the extent that some of their contentions, such as the argument that the Probate Court had exclusive jurisdiction, may not have been tenable.

In any event, the Referee summed up the arguments on jurisdiction as follows:

"For the record, in addition to the petition that was filed, the respondent Pasadena Investment Company has filed an answer and—in which they deny the essential allegations of the petition; they are also objecting to the jurisdiction of this court—with reference to any portion of this property, which was in the course of being probated in the estate of the debtor's deceased husband. The court will rule on that matter of jurisdiction at the proper time." [R.T. p. 1, line 23, to p. 3, line 5.]¹

¹Reference herein to "R.T." means the transcript of the oral proceedings held before Referee Franson. Reference to "T." means the Transcript of the Record certified to by William B. Luck, Clerk.

In discussing this subject, the Referee said:

"This court will acknowledge right here, that you properly objected to jurisdiction, there will be no suggestion that anybody's consented to jurisdiction." [R.T. p. 6, lines 19-22.]

In further elucidation of his position, the Referee stated:

"I would suggest to counsel that this whole procedure might be shortened if we proceed to present the case, having in mind your objection of jurisdiction is preserved, and I will rule on that at the conclusion of the testimony but I don't mean to dictate to you, how you want to present your case." [R.T. p. 16, line 22, to p. 17, line 1.]

After hearing arguments from counsel on this subject, the Referee stated:

"Your Arguments have been well made here, your objections to jurisdiction are duly entered, you haven't consented to jurisdiction so, I would at this time request Mr. Dietrich to proceed with his case on the merits." [R.T. p. 76, line 25, to p. 77, line 2.]

Following this hearing at which substantial conflicting testimony was received, the Referee, on November 15, 1965, signed Findings of Fact, Conclusions of Law and an Order declaring the note and trust deed void as to Appellee, and her deceased husband, and directing that the same be surrendered up by Appellants for cancellation as to such two parties, but not as to Appellee's son, Charles L. Weaver, Jr. [T. pp. 57-67.] In this decision, the Referee determined that, "This Court has jurisdiction to determine the validity of the note

and trust deed." [T. p. 63, lines 24 and 25.] No reference to any statute or authorities was contained therein.

On November 19, 1965, Appellants filed a Petition for a Writ of Review with the Clerk of the United States District Court, pursuant to Section 39 of the Bankruptcy Act (Sec. 67(c), Title 11, U.S.C.A. as amended to July 14, 1960, 74 Stat. 528.)

This petition for review was argued before the Honorable M. D. Crocker, United States District Judge, after having been extensively briefed, and on March 29, 1966, he rendered his decision, the full text of which is as follows:

"Marguerite J. Weaver, as debtor in possession under Chapter XI proceedings, petitioned for an order to show cause to determine validity, nature, extent, priority and amount of claims of lien.

"Both petitioners claimed a lien upon real property, title to which was in the name of debtor and her deceased husband. Debtor was executrix of the Will of her husband, and under the terms of the Will she was the devisee of her husband's interest in the property. The property was leased to a tenant and petitioners therefore claim it was not in the possession of debtor and thus the Referee didn't have jurisdiction.

"Although counsel argues that petitioners waived their objection to jurisdiction, I don't reach that question.

"Debtor was the owner of the property when she filed her petition for arrangement.

"As devisee, the interest of her husband vested in her at the time of his death which was prior to her petition. As owner, she was in constructive possession of the property at the time she filed her petition, even though the actual possession was by her tenant.

"Thus the Referee had jurisdiction to determine the validity of the liens.

"There is ample evidence in the record to support the findings and conclusions of the Referee which are hereby adopted by the court and his order reviewed herein is affirmed." [T. p. 1622.]

Jurisdiction is conferred upon this Court of Appeals to determine the issues raised by this appeal under Section 24a of the Bankruptcy Act (Sec. 47a, Title 11, U.S.C.A.)

See:

Collier Bankruptcy Manual (Second Edition), p. 351, for discussion and citations.

See also:

Section 1291, Title 28, U.S.C.A.

Statement of the Case.

This is an appeal from a judgment of the United States District Court (S.D. Cal. N.D.) affirming an order of the Referee in Bankruptcy which restrained a trust deed foreclosure sale on a fifty-five acre ranch near Tulare, and which held a \$51,000.00 note and such trust deed void as having been obtained by the fraud of two officers of Appellant, Pasadena Investment Co.²

²With respect to the two Appellants, Pasadena Investment Co. and William J. Clark, any reference in this brief to "Appellant" shall mean Appellant Pasadena Investment Co., and when the word "Appellants" is used, it shall include both Appellants.

The proceeding in which the Referee made such order and determination had been filed by Appellee, as the Debtor, under Chapter 11 of the Bankruptcy Act. (Secs. 701, et seq., Title 11, U.S.C.A.)

We have noted that the evidence upon which the Referee made his determination of fraud was sharply conflicting, but we are not seeking a review of any such conflict. We mention it in order to emphasize that Appellants had substantial, and not merely colorable, rights which Appellants were entitled to have determined in a plenary action with appropriate pleadings and all essential parties before a court of competent jurisdiction.

The opinion of the Honorable M. D. Crocker, District Judge, sustained the jurisdiction of the Referee on the ground that the Appellee Debtor was the owner of the ranch, and although not in actual possession, the court ruled that the Debtor was in "constructive possession", in spite of the fact that the ranch was in the actual possession of the sublessee under a term lease and a subsequent term sublease to a man named Turk. [T. p. 1622; R.T. p. 57, line 21, to p. 58, line 1.] No authorities were cited in support of this "constructive possession" theory.

In the concluding paragraph of its opinion, the District Court seems to regard the case as one where it had been asked to review a finding upon conflicting evidence, when the only aspect was that there had been conflicting evidence on the issue of fraud. In other words, this defense was not merely a colorable one, but a substantial one which could not be summarily litigated without the consent of all parties.

Additionally, there was an even broader ground of absence of jurisdiction. This was the absence of jurisdiction in a Chapter 11 proceeding to adjudicate the validity or invalidity of liens on property of a debtor.

The above two points on lack of jurisdiction will be considered under separate subdivisions of this brief. The specification of errors will be very brief, but we will, first, briefly summarize the facts so that this Court may have a clearer picture of the manner in which these questions arose.

The promissory note and deed of trust had been signed and delivered by the Appellee, by her husband, Charles L. Weaver, Sr. (now deceased) and by Charles L. Weaver, Jr. The Appellee alleged in her petition that the promissory note and deed of trust had been obtained by Appellant, Pasadena Investment Co., by means of fraud in the inducement, and the Debtor claimed and testified that an officer of Pasadena Investment Co. had stated to her that the \$51,000.00 note represented a loan made by Pasadena Investment Co. to be used to finance the operation by Mid-Valley Development Co. in a feed brokerage business to be managed by her son, Charles L. Weaver, Jr. [R.T. p. 46, line 10.]

Appellant, William J. Clark, was also made a Respondent in the above-mentioned petition, for the reason that he held title to the promissory note and deed of trust and was alleged to be proceeding to foreclose the trust deed and enforce the note through a sale by Title Insurance and Trust Company, the Trustee under such deed of trust.

The Referee, in his Findings, determined that William J. Clark was not a holder in due course of the

promissory note and ruled that the note and deed of trust were void as to the Debtor, Marguerite J. Weaver, and her deceased husband, Charles L. Weaver, Sr. He, therefore, ordered that the promissory note and deed of trust be delivered up to be cancelled as to Marguerite J. Weaver and Charles L. Weaver, Sr. [T. pp. 57-67.]

All of the foregoing relief was granted, pursuant to the Appellee's petition above mentioned, after a hearing which commenced on the 20th day of August, 1965, before the Honorable Donald R. Franson, Referee in Bankruptcy. [T. p. 57.]

During the hearing before the Referee, there was extensive argument regarding the jurisdiction of the Referee to proceed to determine the validity or invalidity of the promissory note and deed of trust. There was also a special defense of estoppel which was urged as against Appellee because of her delay in taking any proceedings to have the note and deed of trust declared void for fraud, and because of the fact that all three signers of the note, which was dated August 28, 1963, had subsequently signed a letter dated July 23, 1964, reaffirming their liability under such promissory note and deed of trust. A copy of this confirming letter is attached to the Answer of Appellant, William J. Clark, and marked Exhibit "C" thereto. [T. p. 39.]

At this place, we should observe that, although we believe that the estoppel defense is good as to Appellant William J. Clark, who purchased the promissory note after seeing this confirmation [T. p. 62, line 18, to p. 63, line 20], we are not urging the defense of estoppel as to Pasadena Investment Co.

This appeal is not to obtain a review of conflicting evidence, so the only importance of a further statement of facts is to show that there was a substantial bona fide issue as to whether any representative of Pasadena Investment Co. had perpetrated a fraud.

The Referee found that Charles L. Weaver, Jr., the Debtor's son, violated his contractual duties to Pasadena Investment Co., by allowing cattle to be taken from the feed yards, without the feed bills for such cattle having been paid [T. p. 58, line 29, to p. 59, line 16], which thereby resulted in the agistors' liens, for such feed bills upon such cattle, being lost.³

See:

Civil Code, Sec. 3051.

At this time, the feed bills, which were secured by such agistor's liens, had been factored (sold) by Hume Lake Cattle Co. to Pasadena Investment Co., with the result that such accounts (previously secured by the agistor's lien) totaling \$68,036.67, were left without security, and remained unpaid by the various cattle ranchers whose cattle had been in the feed lot before being released to their owners by Charles L. Weaver, Jr. Thereupon, Charles L. Weaver, Jr. signed and delivered to Pasadena Investment Co. his unsecured promissory note dated May 7, 1963, in the sum of \$68,036.67, and Pasadena Investment Co. reassigned to Charles L. Weaver, Jr. the then unsecured invoices evidencing the feed bills totaling \$68,036.67. At the same time, Hume Lake Cattle Co. signed and delivered an unsecured promissory note dated May 8, 1963, in the sum of

³The statements contained herein are covered by the Findings of Fact, p. 3, line 2, to p. 5, line 22.

\$68,036.67 to Charles L. Weaver, Jr., who, in turn, assigned it to Mid-Valley Development Co. as a part of the same transaction. About that time, Pasadena Investment Co. entered into a recourse factoring agreement which was guaranteed by Charles L. Weaver, Sr. Weaver, Jr., acting in his capacity as President of Mid-Valley Development Co., then assigned this promissory note of Hume Lake Cattle Co. to Pasadena Investment Co., and directed Pasadena Investment Co. to apply the \$51,027.50 purchase price, which it was paying, toward the payment of the personal note to Pasadena Investment Co. The Referee found all of this to be without the knowledge or permission of Charles L. Weaver, Sr. [T. p. 61, lines 5-27.]

Charles L. Weaver, Jr. was an officer and employee of Hume Lake Cattle Co. and was also a guarantor of Hume Lake's factoring agreement with Appellant. Additionally, he was an employee of Appellant for the purpose of releasing cattle from the corrals when their owners had paid off their feed bills. [T. p. 58, line 31, to p. 59, line 3.] This function which he performed was similar to that performed in connection with security warehousing, where an employee of the borrower is designated as agent of the warehouse receipt owner to release warehoused merchandise when the warehouse lien thereon has been discharged.

See:

Heffron v. Bank of America (9th Cir.), 113 F. 2d 239; and

McCaffey Canning Co. v. Bank of America, 109 Cal. App. 415 at 436.

No controversy existed as to the liability of Hume Lake Cattle Co. on the \$68,036.67 note which it gave to Charles L. Weaver, Jr. or as to Weaver, Jr. also being liable to Appellant for having wrongfully released the cattle without having received payment on the \$68,-036.67 feed bills. [T. p. 59, lines 3-14.] Appellee does challenge the act of Appellant in using the \$51,027.504 purchase price which Appellant was to pay Mid-Valley Development Co. for the Hume Lake Cattle Co. note to Charles L. Weaver, Jr., which Mid-Valley Development Co. transferred to Appellant as a factoring transaction. Although there was no explicit finding to that effect, it is conceded that the \$51,027.50 purchase price of Appellant was never delivered to either Charles L. Weaver, Jr. or to Mid-Valley Development Co. Instead, it was used by Appellant to discharge the liability of Weaver, Jr. and Hume Lake Cattle Co. to Appellant. This is the essence of Appellee's claim of fraud, because she testified that an officer of Appellant had told her that the \$51,027.50 would be used to provide working capital to Mid-Valley in its business of feeding cattle.

Also, it should be noted that the Findings of Fact are that the assignment and factoring of such promissory note to Pasadena Investment Co. was not in the regular course of business of Mid-Valley Development Co., in that it was normally set up to factor (sell) feed bills for the feeding of cattle. Additionally, the Referee found that Weaver, Jr. did not have any authority to pay his personal obligation to Pasadena Investment Co. with an asset of Mid-Valley Development Co., to wit, the \$51,027.50 sales price of the Hume Lake Cattle Co. note, which would otherwise have been

⁴The Findings sometimes refer to the sum as \$51,027.50 and, at other times, as \$51,000.00, but this difference is of no importance.

receivable by Mid-Valley Development Co. According to the Findings of the Referee, Appellant was lending \$51,000.00 to Mid-Valley Development Co. to be used in its feed brokerage business, managed by Weaver, Jr., and as a result thereof, the Appellee and Weaver, Sr. signed the \$51,000.00 promissory note and trust deed on their land to secure such promissory note, under the belief that the same was to be used in the feed brokerage business of Mid-Valley. The Referee found that the \$68,036.67 Hume Lake note was not an "account" within the meaning of accounts which Mid-Valley was authorized to factor or sell, and that Weaver, Jr. had no right to use the proceeds from the sale of an asset of Mid-Valley (the \$68,036.67 note of Hume Lake or the \$51,027.50) to pay Weaver, Jr.'s personal debt to Appellant. [T. p. 59, line 15, to p. 61, line 6.1

The Referee also found that a representative of Appellant had fraudulently represented to the Debtor and to Weaver, Sr. that the \$51,000.00 loan to Mid-Valley was to be used for working capital by Mid-Valley. [T. p. 59, line 15, to p. 61, line 6.]

The Referee did not find that Appellant Clark was a party to any such fraud, but that he had had past business dealings with Pasadena Investment Co., and that Pasadena Investment Co. had falsely represented to him that the check from Pasadena Investment Co. in the sum of \$51,000.00 was the consideration paid by Pasadena Investment Co. for the \$51,000.00 note and deed of trust. The Referee further found that Clark made no inquiry to the makers of the note before he purchased it, and that Appellant is financially solvent and capable of making full restitution to Clark for any

loss by reason of his purchase of the note. [T. p. 63, lines 13-21.]

There was no Finding with respect to whether Weaver, Jr. was a party to the fraud of Appellant, and, yet, his participation in this fraud, if any fraud existed, is inescapable. He testified that he had requested the representative of Appellant (Perkins) to explain to the two Weaver, Srs. the transaction under which a check was being drawn by Appellant payable to the order of Mid-Valley. [R.T. p. 227, line 20, to p. 228, line 12.]

In other words, Weaver, Jr. attempted to escape responsibility for any fraud by testifying that he did not personally explain the real purpose of this transaction to his parents but that he requested Perkins to do so. It is incredible that, after signing the note and deed of trust on August 28, 1963, Weaver, Jr. would continue to operate Mid-Valley in the feed brokerage business and to successfully conceal from his parents the fact that the \$51,027.50 paid by Appellant had actually been used to repay the unpaid portion of the Hume Lake note. In any event, he would have had to be a party to the initial fraud, as well as to the concealment of the facts which took place thereafter, until around the month of June, 1965, when a Notice of Rescission was sent by Mrs. Weaver, the Debtor.

It is likewise difficult to understand how Weaver, Jr. and his parents could have failed to discuss this transaction for a period of approximately two years after it took place, bearing in mind that there was no showing of any unfriendliness between Weaver, Jr. and his parents. The subject must have come up between the parties during this long period of time, as Weaver, Sr. was also financially interested in Mid-Valley and

its operations. [R.T. p. 234, line 25, to p. 235, line 5.] In addition to this, both Appellee and her now deceased husband signed a letter approximately one year later, wherein they confirmed that their \$51,000.00 note was a valid obligation of theirs. [T. p. 39.]

Appellants' Specification of Errors.

- 1. The District Court erred in determining that it did not need to decide whether the Referee in Bankruptcy had jurisdiction to declare Appellants' trust deed lien void, for the District Court's stated reason that the Appellee Debtor was in constructive possession of the ranch property involved.
- 2. Such Court erred in determining that the lessor (the Debtor) under a term lease was in constructive possession, in spite of such lease and in spite of the fact that physical possession was exclusively in a sub-lessee (Turk) of the lessee (Charles Weaver, Jr.).
- 3. Lack of jurisdiction of the Referee to proceed summarily was not waived by Appellants.
- 4. The District Court erred in failing to take cognizance of another limitation upon the jurisdiction, which is imposed by Sections 307 and 357 of the Bankruptcy Act. (Secs. 707 and 756, Title 11, U.S.C.A.)
- 5. The District Court erred in failing to rule that Appellee was estopped o challenge the enforcibility of the note and trust deed as to its assignee, William J. Clark.
- 6. Because the defense of fraud was based upon substantial evidence, a decision on the questions of jurisdiction should have been made by the District Court.

The first two specifications will be dealt with under a single subdivision of this brief.

ARGUMENT.

T.

The Lessor, Appellee, Did Not Have Any Constructive Possession of the Ranch Which She and Her Deceased Husband Had Leased to Their Son, Charles L. Weaver, Jr., Since 1958.

Charles L. Weaver, Jr. had thereafter subleased the property to a Mr. Turk. [R.T. p. 57, line 23, to p. 58, line 2.]

The Referee, in deciding that he had jurisdiction did not rely upon any theory that a lessor has constructive possession. In any event, we do not believe that such a theory of constructive possession has any basis for application in this case.

Volume 2 of Collier on Bankruptcy (14th Ed.), states that there was "some authority" that a tenant has only a "colorable" claim which could be adjudicated in a summary proceeding. It then states the predominant rule, at page 519, as follows:

"The better view, however, is that a bona fide lessee of the bankrupt's property, who is in possession of the property on the date of bankruptcy, has a substantial adverse claim thereto, which, if asserted, must be determined in a plenary suit in the proper forum, and that the bankruptcy court has no jurisdiction to adjudicate such a claim without the consent of the lessee. The Supreme Court had indicated that in a controversy with his lessor, the possession of the lessee may be independent.

"Where a lease, as in the usual case, conveys to the lessee the right to the use and enjoyment of the property for a specified period, it can hardly be contended that the lessee does not have a substantial interest in the property adverse to that of the bankrupt lessor, nor can the fiction of a constructive possession be raised to overcome the fact of actual possession by the lessee, maintained under a claim of right."

In Foodtown of Oyster Bay, Inc. v. Delbert's Leasing & Devel. Corp., 334 F. 2d 768 (2d Cir.), the court in disapproving the trustee's contention that claims as between the landlord, bankrupt and the lessee were subject to summary jurisdiction, said at page 769:

"The appellee is mistaken in contending that possession by the lessee confers constructive possession on the lessor so as to permit exercise of summary jurisdiction; to the contrary, possession by the lessee under an initially valid lease is hostile to possession by the lessor. See 2 Collier, Bankruptcy, Sec. 23.06(12)."

In re Mt. Forest Fur Farms of America, 122 F. 2d 232 (6th Cir.), the trustee sought to enjoin an oil lessee from carrying on oil drilling operations. The debtor had a 1/8th interest and the lessee a 7/8ths interest. After citing numerous cases limiting the summary jurisdiction of the bankruptcy court, the court stated the rule, at page 243, as follows:

"A mineral lessee may maintain his possession against his lessor as effectively as against any other person. State ex rel. Jennings-Heywood Oil Syndicate v. DeBaillon, 113 La. 572, 37 So. 481, 483. This Louisiana case was quoted and followed

in Pan American Petroleum Co. v. United Lands Co., 5 Cir., 96 F. 2d 26, 28. The Circuit Court of Appeals commented upon the effect of this Louisiana decision: 'A lessee in possession thus may defend his possession against the world, including the lessor * * *."

The rule that a lessor has no constructive possession of the leased property is well established in California. In 30 Cal. Jur. 2d (Landlord and Tenant), the rule is stated at page 249:

"Immediately on commencement of the term, unless special reservation is made, a tenant succeeds to all the rights of the landlord that are annexed to the estate, so far as possession and enjoyment of the premises are concerned. He is entitled to take possession under the lease at any time before his term expires. And when the tenant takes possession the landlord parts with all his right to possession of and control over the premises."

See also:

Walther v. Sierra R. Co., 141 Cal. 288, at 291;Flynn v. Hite, 107 Cal. 455 at 460; andYee Chuck v. Stanford, 179 Cal. App. 2d 405 at 410.

In Volume 8A of Words and Phrases at pages 584 to 587, the general rule stated in the citations therein is that constructive possession does not exist, except where a third party is holding possession through no right or claim of his own, but as an agent for the owner.

In Glens Falls Insurance Co. v. Strom (U.S.D.C. S.C.), 198 Fed. Supp. 450, the court said at page 456:

"Thus, we conclude that since there were adverse claims against the proceeds of the two policies, the policies or the proceeds therefrom, were not in the constructive possession of the bankruptcy court prior to the deposit in this Court."

None of the circumstances for permitting a summary determination exist in the case at bar, such as the following:

- 1. Situations where the rights asserted by the adverse party were merely colorable and did not have sufficient substance to merit their being litigated (*In re Engineers Oil Properties*, 72 Fed. Supp. 989);
- 2. Situations where a claimant had voluntarily consented to the summary proceedings by filing an unqualified claim with the bankruptcy court and thereby submitting to the jurisdiction (See Glens Falls Etc. v. Strom (supra) at page 458 and 2 Collier on Bankruptcy, 14th Ed., pp. 524, et. seq.); and
- 3. Some instances where the trustee has actual possession of the property or fund which is in dispute and which possession he has obtained by voluntary action of the adverse claimant or by voluntary action of the bankrupt (*Long Beach v. Metcalf* (9th Cir.), 103 F. 2d 483).

II.

The Referee's Lack of Jurisdiction to Proceed Summarily Was Waived.

We have already quoted, from Referee Franson, to the effect that he did not believe that the point on lack of jurisdiction had been waived.

Rule 15(b) of the Federal Rules of Civil Procedure contains the following provision:

"When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings."

Also, it has been held that the right to have plenary litigation may be raised at any time before the entry of the final judgment. This rule is stated in 8 Corpus Juris Secundum, Bankruptcy, Sec. 342(16), at page 647, as follows:

". . . that participation in summary proceedings by an adverse claimant does not constitute consent to the exercise of such judication provided formal objection to summary jurisdiction is made before entry of the final order."

See also:

In re Burofsky (D.C. Mass.), 64 Fed. Supp. 128, at 130.

Since neither the Referee nor the Judge of the District Court has sustained any contention that Appellants might have waived their right to object to the summary jurisdiction, there is no purpose of dwelling further on this subject.

III.

Chapter 11, in Dealing With Arrangements Such as the Proceeding Filed by Appellee, Specifically Restricts the Jurisdiction of the Bankruptcy Court to Unsecured Creditors.

Section 356 of the *Bankruptcy Act* (Sec. 756, U.S.C.A., Title 11) states:

"An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or of some class of them, upon any terms or for any consideration."

Section 307 of the *Bankruptcy Act* (Sec. 707, U.SC..A., Title 11) provides:

"Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

- "(1) 'creditors' shall include the holders of all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 103 of this title and whether liquidated or unliquidated, fixed or contingent; and
- "(2) 'debts' or 'claims' shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 103 of this title and whether liquidated or unliquidated, fixed or contingent."

The rule is stated in *Collier Bankruptcy Manual*, page 1089, as follows:

"Only unsecured debts may be affected by an arrangement; mortgages or other liens cannot be modified, reduced or extended under Chapter XI."

In Chaffee County Flourspar Corporation v. Athan, 169 F. 2d 448 (Tenth Circuit), a petition for arrangement under Chapter XI was filed, and the only assets of the debtor listed were a note in the amount of \$140,-000.00, secured by a deed of trust on certain mining property, and an \$8.00 deposit in the bank. The arrangement proposed percentage payments over a period of a number of years. It appeared that, among the secured debts, there were judgments against the debtor, as well as notes secured by deeds of trust and chattel mortgages. The Court noted that the only asset of the debtor "hangs by the thread of the stay order, for without it the sheriff's deed becomes effective and the note worthless." The Court then affirmed the judgment of the District Court, approving an order of the Referee dismissing the arrangement proceedings. In this connection, it said at page 450:

"Since, however, only the right of unsecured creditors of the debtor may be arranged, Securities & Exchange Commission v. United States Realty & Improvement Co., 310 U.S. 434, 60 S. Ct. 1044. 84 L.Ed. 1293, the court should not exercise its injunctive powers in a manner to alter the rights of the secured creditors of the debtor. See Collier on Bankruptcy, 14 Ed., Vol. 8, Sec. 3.22, p. 186. If adequate relief cannot be granted without affecting the rights of the secured creditors, the Bankruptcy Act has provided an adequate remedy in Chapter X and elsewhere in the Act. See Securities & Exchange Commission v. United States Realty & Improvement Co., supra; John Hancock Mutual Life Ins. Co. v. Casev, 1 Cir., 141 F. 2d 104."

In In the Matter of Coyle John Tracy, 194 Fed. Supp. 293, United States District Court, N.D. California N.D., a secured creditor petitioned for review of an order restraining the sale of the debtor's residence and place of business. The District Court held that there was not sufficient evidence in the record to determine whether the Referee should have restrained the foreclosure sale pending the further investigation as to whether the debtor had a substantial equity in the property, and it remanded the case back to the Referee for further proceedings to determine this matter. In recognizing the limited powers of the Bankruptcy Court to restrain the enforcement of liens pending a determination as to whether there was a substantial equity or as to whether the property can be disposed of for an amount in excess of that required to discharge the lien, the Court said at page 295:

"A Chapter XI proceeding may arrange only the rights of unsecured creditors, without alteration of the rights of secured creditors (Bankruptcy Act, section 306(1), Title 11 U.S.C.A. section 706 (1); and Securities & Echange Commission v. United States Realty Co., 310 U.S. 434, 60 S. Ct. 1044, 84 L. Ed. 1293). Nevertheless, the court may, upon notice and for cause shown, stay or enjoin any act to enforce a lien upon the property of a debtor (Bankruptcy Act, Sec. 314, Title 11 U.S.C.A. Sec. 714). The exercise of this power lies within the discretion of the Referee, and his decision to exercise such power must be sus-

tained unless he has abused that discretion (In re Laufer, 2 Cir., 230 F. 2d 866). The exercise of such discretion is, however, subject to equitable consideration, and care should be taken to insure that the stay will cause no substantial injury to the lienor (See Collier on Bankruptcy, 14th ed., Vol. 8, at p. 189; and Chaffee County Flourspar Corp. v. Athans, 10 Cir., 169 F. 2d 448).

"* * *

"This proceeding is strictly an arrangement of a Debtor's difficulties with his unsecured creditors. Its objective is to pay his unsecured creditors in an orderly and expeditious manner, and to keep him, if possible, from being put out of business by his unsecured creditors. This is not a proceeding to rearrange priorities between his secured and unsecured creditors or to handle his difficulties with *secured* creditors. The Court has the power to restrain sale of the property in question under the deeds of trust, only if necessary to facilitate the primary purpose of this proceeding, and if it does not cause substantial injury to the lienor (See Chaffee County Flourspar Corp. v. Athan, supra)." (Italics theirs.)

In the case at bar, the Court was not determining whether there was an equity or whether the debtor might be able to dispose of the property in a sum sufficient to pay the lien holder. It was proceeding to determine, and it did make a final determination, that

the Appellant's note and deed of trust were void. In other words, it imposed a final determination and remedy, which it had no power to do.

In *In re Potts*, 47 Fed. Supp. 990, United States District Court, E.D. Kentucky, the Referee, in a Chapter XI proceedings, denied the debtor's claim of offset against the claim of a secured creditor. The Court referred to the statutes which we have already cited herein, and said at page 992:

"Since it appears from the record in this proceeding without dispute, that the claim of the creditor H. H. Potts was adequately secured by a lien upon the debtor's real estate, his rights as such creditor were not affected by the debtor's proposed arrangement with her unsecured creditors. No order having been entered enjoining the enforcement or foreclosure of his lien upon the debtor's property (section 314, 11 U.S.C.A. sec. 714), he is and was at all times free to enforce his lien without obstruction or interference arising from this proceeding.

"On account of the limited scope of arrangement proceedings under Chapter XI of the Act, it seems clear that the referee erred in assuming jurisdiction to adjudge or determine, in this proceeding, questions involving conflicting claims between the debtor and her secured creditor and in holding that the failure of the secured creditor to accept the proposed arrangement necessarily precluded consideration of it, if in other respects the requirements of Chapter XI were met."

In Securities & Exchange Commission v. United States Realty Co., 310 U.S. 434, 60 S. Ct. 1044, the Court stated the rule at page 1051, as follows:

"Under Chapter XI only the rights of unsecured creditors of the debtor may be arranged and this without alteration of the status of any other classes of security holders or of subsidiaries."

The above limitation upon jurisdiction does not depend upon any lack of possession of a bankruptcy debtor or trustee. It is inherent in the statutes which specifically limit the jurisdiction.

In the case of *Nixon v. Michaels*, 38 F. 2d 420 (8th Circuit), the Court stated at page 423:

"A District Court of the United States sitting as a court of bankruptcy is a court of limited jurisdiction. Limitations exist as to subject matter; as to territory; as to residence and occupation of the debtor to be adjudicated; as to the status of the corporation or person to be adjudicated; and as to other matters. Remington on Bankruptcy (3d Ed.) c. III. And consent cannot confer jurisdiction over the subject matter. The express provisions of the statutes and the necessary implications are controlling (citing cases)."

See also:

8 Corpus Juris Secundum, Bankruptcy, Section 21, at 646.

It is not a question of constructive possession either. The existence of a lien or other security automatically divests the Bankruptcy Court of jurisdiction in a Chapter 11 proceeding.

IV.

Appellee Was Estopped to Attack the Rights of Appellant William J. Clark.

The Referee found that Appellant William J. Clark was not a holder in due course of the promissory note because, at the time he purchased the promissory note, it was then overdue. He also found that William J. Clark could not invoke the defense of estoppel as against the Appellee, even though the first objection which the Appellee made to the promissory note was by way of a Notice of Rescission dated August 9, 1965.

It must be borne in mind that, as late as July 23, 1964, the Appellee, her husband and Charles L. Weaver, Jr. all signed a confirmation of the promissory note in connection with an extension of the due date of such promissory note. [T. p. 39.] We believe that the evidence showed that Mr. Clark had purchased the promissory note and deed of trust in reliance upon this signed confirmation, and that the Appellee was at fault in carelessly permitting the note and deed of trust to go unchallenged until foreclosure proceedings were commenced with respect to the trust deed.

The case of Kelly v. Universal Oil Supply Co., 65 Cal. App. 493, exemplifies the situation involved in the case at bar in that the mortgagors and makers of the promissory note had written a letter similar to the one signed by the Weavers, stating that there were no offsets or any defense against the note. At that time, under the California law, a note secured by a mortgage was

non-negotiable, and the Court, in taking note of this, nevertheless, held that the makers were estopped to assert any defenses to the enforcement of the note and mortgage. The Court said at page 497:

"'Whether a party has, by his own declaration, act, or omission, intentionally and deliberately led another to believe a particular thing true, and to act upon such belief, he cannot, in any litigation arising out of such declaration, act or omission, be permitted to falsify it.' (Code Civ. Proc., sec. 1962, subd. 3.) . . . Their declaration was intended to influence any person who might contemplate the purchase of the securities, and their deliberate failure to disclose any secret equities or conditions relative thereto, of which they had full knowledge, was such an omission of duty as to preclude them from asserting such equities or conditions against one who has been misled by their statement. One form of deceat is 'the suppression of a fact, by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact.' (Civ. Code, sec. 1710, subd. 3.) It is urged that the bank made no inquiries relative to any equities or conditions attaching to the securities. The answer is that under the written representations made by the plaintiffs, and upon which the bank acted, there was no occasion for inquiry. (Porter v. Johnson, 172 Cal. 456 (156 Pac. 1022).)"

See also:

Sherwood v. Robertson, 48 Cal. App. 208 at 211.

V.

Appellant Does Not Need to Belabor the Question Whether There Was Some Evidence of Fraud.

We have reviewed the transaction sufficiently to indicate that this is not a case where the evidence points only in the direction of fraud. We can concede that the circumstances might have been sufficient to justify a determination of fraud on the Appellant's part. The primary point is that the evidence does not point conclusively in the direction of fraud. Both Perkins and Adrianse, the representatives of Appellant, denied any of the contentions that they had misrepresented this transaction to Appellee. [R.T. p. 477, line 18, to p. 478, line 4 — Perkins; p. 437, lines 15-20 — Adrianse.]

Weaver, Jr. attempted to escape responsibility for any fraud by testifying that he did not personally explain the real purpose of this transaction to his parents, but that he had requested Perkins to do this. There was no Finding as to whether Weaver, Jr. was a party to the fraud of Pasadena Investment Co., and, yet, his participation in this fraud, if any fraud existed, is inescapable. He testified that he had requested the representative of Pasadena Investment Co. to explain to his parents the transaction under which a check was being drawn, payable to the order of Mid-Valley.

In other words, Weaver, Jr. attempted to escape responsibility for any fraud by testifying that he did not personally explain the real purpose of this transaction to his parents, but that he had requested Perkins to do so. [R.T. p. 227, line 24, to p. 228, line 6.] It is incredible that, after signing the note and trust deed on August 28, 1963, Weaver, Jr. would continue to operate Mid-Valley in the feed brokerage business and to suc-

cessfully conceal from his parents the fact that the \$51,-027.50 had actually been used by Appellant to repay the unpaid portion of the Hume Lake Cattle Co. note. In any event, Weaver, Jr. would have had to be a party to the initial fraud, as well as to the concealment of the facts which took place thereafter, until around the month of June, 1965, when a Notice of Rescission was sent by Mrs. Weaver, the Debtor.

It is, likewise, difficult to understand how Weaver, Jr. and his two parents could have failed to discuss this transaction for a period of approximately two years after it took place, bearing in mind that there was no showing of any unfriendliness between Weaver, Jr. and his parents. The subject must have come up between the parties during this long period of time as Weaver, Sr. was also financially interested in Mid-Valley and its operations. [R.T. p. 234, line 25, to p. 235, line 1.]

At this point, we should add that neither the Appellee nor her deceased husband should be able to disavow the acts of their agent, Weaver, Jr., even assuming that they had not expressly authorized him to perpetrate any fraud upon Appellant by releasing cattle from the corrals of the Hume Lake Cattle Co.

See also:

Blackburn v. Witter, 201 Cal. App. 2d 518 at 521;

Ghiglione v. American Trust Co., 49 Cal. App. 2d 633;

Bank of Palo Alto v. Pacific Postal Cable Co., 103 Fed. 841 at 846; and

21 California Jurisprudence 2d (Agency). Section 156, page 852.

We mention these matters, because Appellant has been the one who has been taken advantage of from the inception, and, yet, it finds itself penalized by having the \$51,000.00 note and deed of trust declared void as to both the debtor and her deceased husband. This occurred in spite of the fact that fraud must be proved by the party asserting it and that it is never presumed.

See:

23 California Jurisprudence 2d (Fraud and Deceit), Section 73, pages 182, et seq.

This is important, because both Mr. Perkins and Mr. Adrianse of Pasadena Investment Co. denied making any representations to either of the Weaver Srs. regarding the purpose of the \$51,000.00 note and deed of trust which was signed by all three of the Weavers. [R.T. p. 477, line 18, to p. 478, line 4; Perkins, R.T. p. 437, lines 15-20; Adrianse.]

Furthermore, Charles Weaver, Jr. admitted that he did not personally hear any representations made by any Pasadena Investment Co. representatives to the Weaver Srs., but that Mr. Perkins stated to him that he would explain the transaction to Mrs. Weaver. [R.T. p. 227, line 24, to p. 228, line 6.]

As an example of the weak evidence which the Referee relied upon to support his determination of fraud, we quote from the testimony of Mrs. Weaver, the debtor, as follows:

"A. Well, in the first place, my son asked Mr. Perkins to tell us the occasion — for this meeting —

Q. To explain the details? A. To explain the details of this meeting and he explained it that

Pasadena Investment Company was—loan us \$51,-000.00 to finance the operations of the Mid-Valley Investment Company—

- Q. Mid-Valley Development Company? A. Mid-Valley Development Company, to—as a brokerage firm.
- Q. What kind of a brokerage firm? A. They were to sell—handle feed for the cattle in the Hume Lake Cattle lot; at a percentage of course—profit, and it looked as the way they presented it that it—

Mr. Clark: Now I submit that she's going beyond what was said and I move that that be stricken.

The Referee: The answer will be stricken—

Mrs. Weaver: They presented it in a way—

Mr. Clark: Now just-

The Referee: Mrs. Weaver I think perhaps you should—wait for the next question from counsel.

Mr. Dietrich: Q. Now we were referring to conversations with this, that you just related explained to you by Mr. Perkins— A. Yes it was.

- Q.—and what else did Mr. Perkins say, if anything? A. Well I can remember one direct quote, he said 'Well we want to see Charles make some money for himself.'
- Q. Can you remember specifically anything else that Mr. Perkins said—at this time? A. No, I can't—it was just the general discussion of the way that this would be handled—in the factoring through Pasadena Development Company." [R.T. p. 46, line 5, to p. 47, line 11.]

It will be noted that Mrs. Weaver makes reference to the word "factoring" in her above testimony, and, yet, on the same occasion, she testified that she did not understand factoring at all. [R.T. pp. 48 and 113.] It is, therefore, even more incredible that she would have signed papers concerning a transaction on factoring if she did not understand it. She would at least have asked some questions of someone. Of course, she testified that even though the \$51,000.00 proceeds were to be used to repay the Hume Lake obligation and her son's obligation, she would have signed the documents which she did sign if her husband had asked her to do so. [R.T. p. 128.]

It is inconceivable that she and her husband would have come into town and met with the two representatives of Pasadena Investment Co. and her son if they had not been told something about the purpose of their mission, and if it is true that they had been so told, it is more incomprehensible that they would have proceeded to blindly sign the documents without some interrogation of their own son, as this was not an insignificant transaction. It is likewise unbelievable that their son would have concealed his own errors from his parents in releasing cattle from the feed lot and thereby giving rise to this liability. He would normally not be so lacking in courage as to delegate to strangers the function of explaining such matters to his parents without his being present to correct any such explanation or to justify himself.

Regardless of how the decision of the Referee is interpreted, it leads to one positive conclusion, and that is that, if there was any basis at all for fraud as against Pasadena Investment Co., then the Debtor's own son was not only involved in a grosser type of fraud on his own parents but was so completely lacking in courage as to be unworthy of belief under any circumstances.

It is incredible that, at the time of the signing of a confirmation of the note and deed of trust, approximately one year later, neither of the Weaver Srs. would have known the facts, particularly when Weaver, Sr. was supposed to be a one-half owner of the venture being carried on by Mid-Valley Development Company. Her testimony regarding her discussions with her husband on this subject is as follows:

"Q. Did you have any discussion with your husband as to why you were signing this document? A. Well, naturally we talked it over." [R.T. p. 107, lines 6-8.]

Conclusion.

This case is anomalous in many respects. It involves a situation where Appellant was defrauded in the sum of \$68,000.00 by the act of Weaver Jr. in releasing cattle and thereby destroying the agistor's lien which accompanied the invoices purchased by Appellant. Subsequent to Appellant applying the \$51,027.50 to reimburse it for the loss which Weaver, Jr. had caused it, the Debtor filed a Chapter 11 proceedings, although she had no debts to general creditors except a very few nominal ones totaling less than \$1,000.00. [T. p. 30, lines 27-29.] Then, with no Receiver or Trustee appointed, the present proceedings were instituted before the Referee in Bankruptcy for the sole purpose of having the \$51,000.00 note and trust deed declared void and unenforcible.

Such objective was achieved before the Referee in Bankruptcy, and this was affirmed by the Judge of the District Court. This accomplishment, if permitted to stand, renders no longer necessary the continuation of the Chapter 11 proceedings, because if the deed of trust is eliminated from the Debtor's property, she can dismiss the Chapter 11 proceedings and go forth without further concern over this obligation.

Not only would such a result be achieved, but it would be achieved in a statutory proceeding which has been created for the sole purpose of consummating arrangements with general unsecured creditors. Not only does the Bankruptcy Court lack plenary jurisdiction over such matters, but it lacks any jurisdiction whatsoever where a Chapter 11 proceeding is involved.

It is a prime example of the use of a tribunal for a purpose which was never contemplated by Congress; and the general inadequacy of such a remedy is apparent by the fact that the Referee did all of these things without making any finding as to the guilt or innocence of Weaver Jr. and without being able to make any direction for restitution to Appellant Clark on account of his purchasing the promissory note from Appellant Pasadena Investment Co. He is required by the Referee to rely upon the good faith of a company (Pasadena Investment Co.), found by the Referee to be guilty of fraud, to voluntarily reimburse him for his loss.

We respectfully submit that the decision of the District Court should be reversed and that the order of the Referee should be set aside with directions to dismiss the proceedings without prejudice to any right on the part of the Debtor to maintain them in a court of proper jurisdiction.

Respectfully submitted,

McLaughlin & McLaughlin, By James A. McLaughlin, Attorneys for Appellants, Pasadena Investment Co. and William J. Clark.



Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES A. McLAUGHLIN







EXHIBITS.

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н	2		21
11	3		21
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11	5		23
ti	6		23
11	7	24	26
10	8		42
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11	10		44
11	11		98
н	12		102
11	13		102
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**	15		102
11	16		130
"	17	132	268
11	18	134	154
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"	20	135	154
11	21	135	154
**	22	136	206
**	23		136
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17	25		143
11	26		194
н	27		217
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11	29		218
11	30		220
"	31		220
"	32		220
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Exhibit No.		Identification	In Evidence
11	34		272
**	35		282
11	36		288
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n .	40		312
"	41		322
11	42		344
II .	43		347
II .	44		351
"	45		357
11	46		368
11	47		401
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**	49		402
**	50		413
"	51		462
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n.	В		268
11	С		416
11	D		419
"	E		440
"	F		445
Respondent (Clark's		
11	I		258
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**	IV		490

No. 21,003

IN THE

United States Court of Appeals For the Ninth Circuit

Pasadena Investment Company and William J. Clark,

Appellants,

VS.

MARGUERITE J. WEAVER,

Appellee.

APPELLEE'S BRIEF

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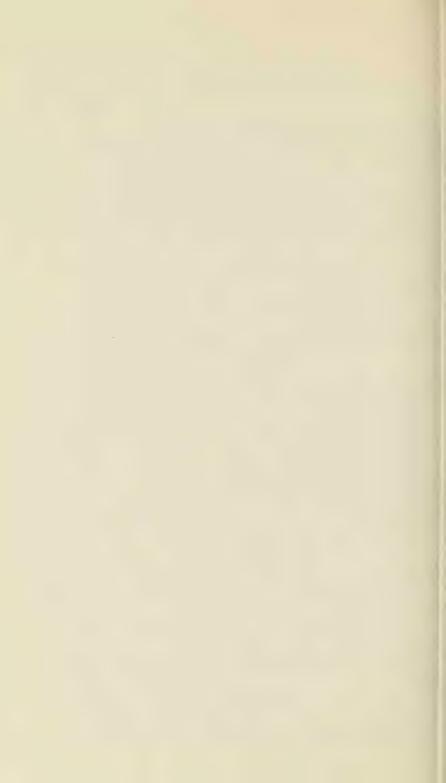
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IN THE

United States Court of Appeals For the Ninth Circuit

Pasadena Investment Company and William J. Clark,

Appellants,

VS.

MARGUERITE J. WEAVER,

Appellee.

APPELLEE'S BRIEF

STATEMENT OF PLEADINGS AND FACTS DISCLOSING JURISDICTION

On June 22, 1965, appellee Marguerite J. Weaver filed her petition for an arrangement under Chapter XI of the Bankruptcy Act. On August 2, 1965, Marguerite J. Weaver, as debtor in possession, filed a Petition to Determine Validity, Nature, Extent, Priority and Amount of Claims of Lien on debtor's real property against respondents Pasadena Investment Company, William J. Clark and Title Insurance and Trust Company. (T. p. 13.) A three day trial was

¹(References used in this brief are "T." for the Transcript of Record certified by the Clerk of the United States Court of Appeals for the Ninth Circuit and "R.T." for the Reporter's Transcript of testimony taken at the trial.)

held before Honorable Donald R. Franson, Referee In Bankruptcy and the Findings of Fact, Conclusions of Law and Order of the Bankruptcy Court were entered on November 15, 1965 (T. p. 57), holding that a promissory note and deed of trust executed by appellee and her late husband on August 28, 1963 were void for fraud, mistake and failure of consideration.

On November 19, 1965, appellants filed a Petition for Review (T. p. 69) pursuant to Bankruptcy Act §39c (11 USCA 67c). On March 29, 1966 the Honorable M. D. Crocker, United States District Judge, filed his Order which affirmed the Referee's order of November 15, 1965 (T. p. 162), pursuant to the jurisdiction of the United States District Court to consider findings and orders certified by referees and to confirm, modify or reverse such findings and orders under Bankruptcy Act Section 2a (10), (11 USCA 11) and General Order 47 (General Orders In Bankruptcy adopted by the Supreme Court of the United States).

Appellants filed their Notice of Appeal on April 13, 1966 (T. p. 151) and jurisdiction is conferred upon this court by Bankruptcy Act Section 24a (11 USCA 47a).

STATEMENT OF THE CASE

The Findings of Fact (T. p. 57) contain a concise summary of the facts of the case. The appeal raises only two issues: one, whether the Bankruptcy Court had summary jurisdiction to make its order voiding the

debtor's promissory note secured by deed of trust on the debtor's real property on grounds of fraud, mistake and failure of consideration; and two, whether there is evidence to support the Bankruptcy Court's finding that the debtor is not estopped to assert the grounds of fraud, mistake and failure of consideration against appellant William J. Clark who purchased the note and trust deed after the note was past due.

Since the estoppel issue is the only issue on the merits in this appeal, the facts relating to it are fully set forth in paragraph II of the Argument in this brief, where that issue is treated.

ARGUMENT

T.

THE BANKRUPTCY COURT HAD JURISDICTION TO RULE UPON THE VALIDITY OF THE PROMISSORY NOTE AND DEED OF TRUST.

A. The Bankruptcy Court Had Jurisdiction by the Consent of Both of the Appellants.

Both Pasadena Investment Company and William J. Clark, respondents to debtor's petition to determine the validity, nature, extent, priority and amount of their claims of lien against debtor's 55 acre ranch, consented to jurisdiction by filing their answers in the Bankruptcy Court. The applicable part of Section 2a(7) of the Bankruptcy Act (11 USCA 11) provides as follows:

"... where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;"

The answer of Appellant, Pasadena Investment Company, contains absolutely no objection to the summary jurisdiction of the Bankruptcy Court to proceed to hear the petition. In fact, it prays for affirmative relief:

"Wherefore your respondent prays this court make an appropriate order establishing the validity of the promissory note and deed of trust and authorizing the holder of the promissory note and deed of trust do (sic) all things necessary and proper in the foreclosure of said deed of trust and sale of the real property pursuant to and in accordance with the terms of said deed of trust." (T. p. 19.)

Thus, Pasadena Investment Company invoked the Bankruptcy Court's jurisdiction to determine that the deed of trust was valid, and consented to the Bankruptcy Court's jurisdiction. (Collier on Bankruptcy, 14th ed., Vol. 2, paragraph 23.08 (5); In re Engineers Oil Properties Corp. (S.D. N.Y. 1947) 72 F. Supp. 989.

The answer of the appellant, William J. Clark, does not object to the summary jurisdiction of the Court, but alleges "that the Court has no jurisdiction under Section 4 of the Bankruptcy Act over thirty-eight (38) of the fifty-four (54) acres shown in exhibit 'A' of debtor's petition . . .". Appellant Clark then invoked the jurisdiction of the Bankruptcy Court by praying for affirmative relief:

"Wherefore, your respondent prays this Court make an appropriate order establishing the validity of the promissory note and deed of trust and authorizing the Title Insurance and Trust Company, as Trustee, holder of the promissory note and deed of trust, to do all things necessary and proper in the foreclosure of said deed of trust and sale of the real property, pursuant to and in accordance with the terms of the said deed of trust; and that the rent money collected since the filing of the Bankruptcy be ordered to be returned to be held by the Court appointed Trustee, as part of the security for respondent beneficiary under the terms of the Trust." (T. p. 29.)

At no time did either appellant argue that the Bankruptcy Court had no jurisdiction. An examination of the transcript will show that the oral arguments of both respondents at the time of trial were based solely upon the proposition that the Bankruptcy Court had no jurisdiction over *part* of the ranch acreage. Pasadena and Clark on the first day of trial argued that thirty-eight (38) acres of the ranch plus one-half of the remaining acreage was the separate

property of the debtor's deceased husband, Charles L. Weaver, Sr. and that this property was under the sole jurisdiction of the Probate Court in Tulare County. (R.T. pp. 1-18.)

"The Referee: Do you contend that this court doesn't have jurisdiction to determine the validity of this deed of trust insofar as Marguerite J. Weaver's interest is concerned?

Mr. Davidson: No. I do not contend as far as the 6 acres is concerned . . .

The Referee: We're in agreement on that point.

Mr. Davidson: Right. We're in agreement on that point. . . ." (R.T. p. 9; see also R.T. p. 66.)

Appellant's only real argument about jurisdiction was that the Bankruptey Court had no jurisdiction over a part of Mrs. Weaver's ranch. Since both appellants invoked the aid of the Bankruptey Court in declaring the subject Promissory Note and deed of trust valid, there should be no question that the Bankruptey Court had summary jurisdiction by their consent.

- B. The Bankruptcy Court Had Summary Jurisdiction to Determine the Validity of the Deed of Trust Because It Affected the Debtor's Title and Ownership of Her Real Property.
- 1. Mrs. Weaver Owned the Ranch and Her Title Was Not in Dispute.

The ranch belonged to Mr. and Mrs. Weaver, Sr. (R.T. pp. 23-26) and had been leased since 1958 when Mr. Weaver, Sr. retired (R.T. p. 31, R.T. p. 58). The ranch is located within the jurisdiction of the Bankruptcy Court a few miles outside the City of Tulare,

California. (R.T. p. 22, R.T. p. 59.) The Weaver Seniors did not live on the ranch but lived in the City of Tulare. (R.T. p. 19, R.T. p. 53.) The ranch was unencumbered when Mr. and Mrs. Weaver, Sr. signed the promissory note for \$51,000.00 secured by a deed of trust on their ranch on August 28, 1963. (Debtor's Exhibits 8 and 9; R.T. p. 22.) Charles L. Weaver, Sr. was killed on August 18, 1964 (R.T. p. 19) leaving a will with his wife, Marguerite J. Weaver, the debtor herein, as sole beneficiary and executrix (Debtor's Exhibit 1). Mrs. Weaver filed her petition under Chapter XI on June 22, 1965. At that time the property was physically in the possession of a subtenant. Neither respondent Clark nor respondent Pasadena was in possession. (R.T. pp. 56-58.) On July 7, 1965, the will was admitted to probate in Tulare County and Mrs. Weaver was appointed executrix of the will of Charles L. Weaver, Sr. (Debtor's Exhibits 2 and 3.)

Mrs. Weaver had title to the ranch from the date of her husband's death on August 18, 1964. The general rule is that real property vests instantly at the death of the testator. Collier on Bankruptcy, 14th ed., Vol. 4, p. 1232, §70.27; Atkinson on Wills (1937) pages 528-529; California Probate Code §300. In California, when a person dies, the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his last will subject only to the possession of the executor and to the control of the Superior Court for the purposes of administration. (Probate Code §300.) In other words, title

does not come from the decree of distribution, which merely declares the title that came from the will or through the death of the decedent. (See *U.S. Fidelity, etc. Co. v. Mathews,* 207 Cal. 556, 279 P. 655; *Murphy v. Crouse,* 135 Cal. 14, 66 P. 871; *Reed v. Hayward,* 23 Cal. 2d 336 at 342, 73 P. 2d 247 at 252.)

The Bankruptcy Court Had Exclusive Summary Jurisdiction Based Upon Mrs. Weaver's Undisputed Title to the Ranch.

Since many of the cases cited in the following discussion arise in straight bankruptcy proceedings it is helpful to keep in mind that the debtor in possession under a Ch. XI arrangement proceeding has the same powers as a trustee in bankruptcy. As stated in Section 342 of Ch. XI of the Bankruptcy Act "... the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act ..." Also, Section 302 makes the provisions of Chapters I through VII of the Bankruptcy Act applicable to Ch. XI proceedings whenever they are not inconsistent. (11 USCA 742 and 702.)

Appellants challenge the jurisdiction of the Bank-ruptcy Court because Mrs. Weaver's ranch was leased and she was not in physical possession of it. (Argument, Section I, Appellants' Opening Brief, pp. 15-18.) The point is attempted to be based upon the well recognized rule that where an adverse claimant is in possession of property, the Bankruptcy Court has no summary jurisdiction to determine the title or rights in the property held by the adverse claimant. In our

case Mrs. Weaver is the owner of the real property, a subtenant who has no dispute with the debtor is in physical possession of the real property, but the issue is between Mrs. Weaver and the appellants who are not in physical possession of the real property.

Section 311 of the Bankruptcy Act states that the Bankruptcy Court shall have exclusive jurisdiction over the debtor and his property.

"Where not inconsistent with the provisions of this Chapter, the court in which the petition is filed shall, for purposes of this Chapter, have exclusive jurisdiction over the debtor and his property, wherever located." (Bankruptcy Act, Sec. 311, 11 USCA 711.)

This Court has stated that Section 311 confers exclusive summary jurisdiction over property not in the debtor's possession where the debtor's title is not in dispute:

"Section 311 confers exclusive summary jurisdiction to determine controversies to property owned by the debtor, or in the actual or constructive possession of the debtor or the bankruptcy court. Slenderella Systems of Berkeley, Inc. v. Pacific Tel & Tel Co. (2 Cir. 1961) 286 F 2d 488, 490, see 8 Collier on Bankruptcy (14th Ed 1963) \$\mathbb{1} 3.02\$. This includes property not in the possession of the debtor, where the debtor's title is not in dispute. See 8 Collier, Supra, at 181-182."

Loyd v. Stewart & Nuss, Inc., (C.A. 9th 1964) 327 F. 2d 642 at 645.

Since Mrs. Weaver's title to the ranch is not in dispute, the Bankruptcy Court has exclusive sum-

mary jurisdiction based upon Section 311 of the Bankruptey Act.

 Mrs. Weaver as a Lessor Owns the Underlying Title to Her Leased Real Property and It Is by Law in the Constructive Possession of the Bankruptcy Court and Subject to Its Summary Jurisdiction.

The law of real property generally and in California specifically, defines as a "reversion" that which the lessor has left after he has leased real property for a term of years to a tenant. In California the lessor's reversion is defined as follows:

"A reversion is the residue of an estate left by operation of law in the grantor or his successors, or in the successors of a testator, commencing in possession on the determination of a particular estate granted or devised." (California Civil Code Section 768; see Ogden's California Real Property Law, Sections 2.10 and 2.11.)

A lessor, as owner of real property, may sell the land during an unexpired leasehold term, in which event the vendee becomes the landlord by operation of law and the tenant becomes a tenant of the vendee of the reversion. (*Upton v. Toth*, 36 C.A. 2d 679, 98 P. 2d 515.)

Thus in our case Mrs. Weaver was the owner of the ranch which she had leased out. Her property rights were the right to receive rent under the lease and her reversionary interest in the land. The case of Benton v. Calloway, 165 F. 2d 877 (5th Cir. 1948) affirmed by the United States Supreme Court in 336 U.S. 132, 69 S. Ct. 435, 93 L. Ed. 553, is directly in point except that it must be kept in mind that it was

the tenant who was the debtor in that corporate reorganization proceeding. The Court in the Calloway
case states that because the lessee in actual possession
of the tangible property leased by it is the debtor,
the Bankruptcy Court has summary jurisdiction over
the leased property but does not have summary jurisdiction over the reversion in the leased premises because the lessor is not in bankruptcy. On the other
hand, the Court states that if the lessor were in bankruptcy, then the Court would have jurisdiction in rem
over the reversion but not over the tenant's leasehold, and the reversion being intangible property,
the ownership of it in the lessor carries with it the
legal consequences of possession, giving the Bankruptcy Court summary jurisdiction.

"The debtor was in actual possession of the tangible property leased by it, but it held the same as lessee, not as owner in fee. The granting of a lease always supposes the grantor reserves to himself a reversion in the leased premises. A leasehold estate is personal property which becomes subject to the exclusive jurisdiction of the bankruptcy court upon the filing of a petition by the debtor under said section 77; but the lessor's title in fee, out of which the leasehold was carved, was not an asset of the debtor, and no claim of title thereto or lien thereon is made by the debtor or its trustee.

The jurisdiction of the federal district courts sitting in bankruptcy is limited to matters conferred by statute expressly or impliedly. Such jurisdiction is paramount and exclusive in the administration of the bankrupt's estate. The

basis of the court's exclusive jurisdiction in rem is its actual or constructive possession of the debtor's property. It is not limited to the administration of property that belonged to the debtor without question, but extends to the determination of all questions of title or liens affecting the debtor's estate. It is not exclusive as to the right or title of a party not in bankruptcy to property not legally or equitably owned or claimed by the debtor. . . ." (Page 880.)

. .

"It is well settled that the bankruptcy court has no summary or exclusive jurisdiction in rem of tangible property adversely held by a third party under a bona fide claim of ownership. The same is true of intangible property, except that ownership of the latter carries with it the legal consequences of possession. In the case of a reversion the law attributes to ownership the jurisdictional consequences of possession. To illustrate, let us suppose that South-Western (the lessor) were the debtor here, and that Central (the tenant) were a solvent corporation holding under its lease. The bankruptcy court would have jurisdiction in rem, of the reversion, but not of the leasehold." (Page 882, emphasis added; material in parenthesis added.)

The same rules are laid down in *Texas and N.O.R.* Co. v. Phillips (5th Cir.), 211 F. 2d 419; certiorari denied 348 U.S. 913, 75 S. Ct. 293, 99 L. Ed. 716.

The case at bar is an illustration of the general rule that where the character of the property is such that it is not capable of tangible or actual physical possession the law deems such property to be in the constructive possession of its owner and that constructive possession is sufficient to confer summary jurisdiction in the Bankruptcy Court. Collier on Bankruptcy, 14th ed., Vol. 2, par. 23.05, page 485. For example, see In Re Marsters (C.A. 7th), 101 F. 2d 365, cert. den. 306 U.S. 663, 59 S. Ct. 788, 83 L. Ed. 1059, where the asset was a judgment owned by the bankrupt; In Re Worral (C.A. 2d) 79 F. 2d 88 where the asset was a seat on the New York Stock Exchange; and Benton v. Calloway (supra) where the asset discussed in dicta was a lessor's reversion.

A lienholder not in possession of the property upon which he claims a lien is not an adverse holder and the Bankruptcy Court may determine questions as to the lien in a summary proceeding. See *Dugan v. Logan*, 229 Ky. 5, 16 S.W. 2d 763 at 766, cert. den. 280 U.S. 587, 50 S. Ct. 36, 74 L. Ed. 636; *Fish v. East* (C.A. 10th) 114 F. 2d 177 at 194. Appellants were not in possession of the real property.

Thus Mrs. Weaver's fee title to the land—her "reversion"—was intangible property in the constructive possession of the Court and the Court had the summary jurisdiction to rule on the validity of the deed of trust which could have destroyed the reversion.

 The Summary Jurisdiction of the Bankruptcy Court Includes the Power to Determine the Validity of a Lien Against the Debtor's Ranch.

Section III of appellants' argument is devoted to the proposition that the Bankruptcy Court had no jurisdiction because Ch. XI Arrangements are meant to affect only unsecured indebtedness. (Appellants' Opening Brief, pp. 20-25.) Appellants summarize their position with this amazing statement:

"It is not a question of constructive possession either. The existence of a lien or other security automatically divests the Bankruptcy Court of jurisdiction in a Chapter II proceeding." (Appellants Opening Brief, p. 25.)

Unfortunately none of the cases cited by petitioners are in point. Generally all they do is discuss the general proposition that a plan of arrangement is meant to affect only unsecured creditors of the debtor. No one denies the correctness of that rule in context. But here the issue is whether the referee has jurisdiction to determine the validity of a lien claimed against the debtor's property. The correct rule is that valid liens existing at the time of the commencement of either a bankruptcy or Chapter XI arrangement proceeding will not be distributed, except that they are subject to administration in the Bankruptcy Court and the Court always has the power to determine their validity, amount and priority. The case of City of Long Beach v. Metcalf (C.A. 9th) 103 F. 2d 483, at 486-487, cert. den. 308 U.S. 602, 60 S. Ct. 139, 84 L. Ed. 504 summarizes the rules on summary jurisdiction. See also In Re American Fidelity Corp. Ltd. (D.C. S.D. Cal.) 28 F. Supp. 462.

On adjudication in bankruptcy (or filing a petition in Ch. XI) title to land belonging to the bankrupt vests in the trustee or debtor in possession and jurisdiction to determine the validity and amount of lien on land and to decree the method of liquidation is lodged in the Federal Court and cannot thereafter be taken by the state Court. Adolph Ramish, Inc. v. Laugharn (C.A. 9th) 86 F. 2d 686. The Supreme Court of the United States has stated these rules in Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734, 51 S. Ct. 270, 75 L. Ed. 645:

"Thus while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation." (51 S. Ct. at 272.)

. . .

"The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of both secured and unsecured creditors." (51 S. Ct. 272.)

These same rules are stated by the Ninth Circuit Court of Appeals in Heffron v. Western Loan and Building Co., 84 F. 2d 301:

"While valid liens created more than four months prior to the filing of the petition are declared by section 67 of the Bankruptcy Act to be unaffected by bankruptcy proceedings, such liens nevertheless may be subjected to administration by the court and their validity and enforcement determined and carried out by the court."

Specific cases holding security interests invalid by the Bankruptcy Court are In Re Kellogg (C.A. 2d) 121 Fed. 333 where a mortgage upon real property was held void for usury; and In Re Rochford (C.A. 8th) 124 Fed. 182, where a chattel mortgage was held void as against creditors of the bankrupt. Both cases are directly in point. The issue on appeal was whether the question of validity and amount of a mortgage lien upon property of the bankrupt estate can be determined in a summary proceeding before a referee.

II.

THE PETITIONER WILLIAM CLARK PURCHASED THE OVER-DUE WEAVER SENIOR NOTE AND WAS THEREFORE NOT A HOLDER IN DUE COURSE AND WAS SUBJECT TO THE DEFENSES OF FRAUD, MISTAKE AND FAILURE OF CON-SIDERATION UNLESS THE WEAVERS ARE ESTOPPED TO ASSERT THEM. THE REFEREE'S FINDINGS AGAINST ESTOPPEL ARE FULLY SUPPORTED BY THE EVIDENCE.

The only attack upon the merits of the Referee's decision is made on the ground that Mrs. Weaver is estopped to attack the rights of appellant William J. Clark. (Appellant's Opening Brief, Section IV, pp. 26-27.) The estoppel defense is not urged as to appellant Pasadena Investment Co. (Appellant's Opening Brief, p. 8.) Nor is their any appeal from the Referee's fraud findings (Appellant's Opening Brief, p. 6), yet appellants entitle Section V of their opening brief, "Appellant Does Not Need to Belabor The Question Whether There Was Some Evidence of Fraud"! (pp. 28-33). Having conceded that they acquiesce in the evidentiary support for the findings

of fraud, appellant's discussion can only be presumed to be an attempt to leave this Court with the imprespsion that somehow there was no fraud and in any event another Court should have ruled on that question.

As to the estoppel defense raised by appellant Clark, in his trial brief to the Bankruptcy Court, Mr. Clark conceded that he is not a holder in due course, having purchased the Weaver Senior note after its maturity. (California Civil Code Section 3133 (2). Therefore, Mr. Clark is subject to all of the grounds for rescission of fraud, mistake and failure of consideration which Mrs. Weaver has against Pasadena Investment Company unless Mrs. Weaver is estopped to assert them. Pacific Southwest Trust and Savings Bank v. Valley Finance Corporation, 99 C.A. 728 (California Supreme Court hearing denied).

By Mr. Clark's own testimony it is clear that when he purchased the Weaver note and deed of trust from Pasadena Investment Company, in February 1965, he did not depend solely upon the Weaver letter of July 23, 1964. (Debtor's Exhibit 11; R.T. p. 493, line 8 through p. 495, line 10.) Upon his demand for proof that consideration was given for the note and deed of trust, Pasadena Investment Company showed him its cancelled check to the Weavers for \$51,000.00. (R.T. p. 494, lines 8 and 9 and p. 495, lines 2-7; Debtor's Exhibit 10.) That check never represented payment of money at all (R.T. p. 299, line 3 to p. 301, line 3), but Pasadena did not hesitate to represent it as the purported consideration for the Weaver Senior

note and deed of trust. Mr. Clark's testimony also shows that Pasadena falsely represented to him that no interest had been paid on the Weaver Senior note and that he was entitled to the accrued interest (R.T. p. 493, lines 14-19) which would have been \$5,440.00 at the time he purchased the note. (Other evidence proved that while the Weavers had not paid any interest on their note, Pasadena Investment Company had paid itself \$3,047.98 of interest from the money it controlled in the Hume Lake Cattle Company rebate account.) (R.T. p. 290, lines 17-23; p. 318, lines 3-10.) So, Mr. Clark purchased the overdue note knowing that the Weavers had never paid one penny on principal or interest (R.T. p. 493, lines 16-17) and without talking to any of the Weavers or visiting the Weaver ranch (R.T. p. 500, lines 7-15.)

It is clear from the record that Mr. Clark relied just as much on the misrepresentations of Pasadena Investment Company that they had paid the \$51,000.00 cash for the Weaver Senior note and deed of trust and that there was \$5,440.00 accrued interest on the note to induce him to purchase it as there was any reliance by Mr. Clark upon the Weaver Senior's signature to the letter of July 23, 1964. (R.T. p. 493, line 8 to R.T. p. 495, line 9.) It is doubtful that Mr. Clark, an attorney at law (R.T. p. 491, lines 20-21), should even be able to claim justifiable reliance on the letter of July 23, 1964 since it is not addressed to him or any other third party and was six months old at the time he took the assignment of the note and trust deed (Debtor's Exhibit 11).

There is no serious threat of harm to Mr. Clark because Pasadena Investment Company is fully willing and able to reimburse him. Pasadena Investment . Company made a big point of its financial standing and the fact that it had a million eight hundred thou-' sand dollar line of credit with the Bank of America. (R.T. p. 421, lines 5-11.) The appellants have inferred by their "Stipulation Staying Portion of Order Pending Determination, etc." (T. p. 84) that Pasadena Investment Company is ready to reimburse Mr. Clark, if, in fact, it has not already done so. If this case were to be decided upon the basis that Mrs. Weaver was estopped to assert the fraud, mistake and failure of consideration and the case were not allowed to be decided on the merits, the result would be disastrous to Mrs. Weaver and unjustly enrich Pasadena Investment Company. In that case, Pasadena Investment Company would be allowed to keep the \$50,508.55 paid to it by Mr. Clark (R.T. p. 487) and Mr. Clark would take the Weaver ranch which he believes is worth at least \$1,100.00 an acre, or approximately \$60,500.00 (R.T. p. 492).

This obviously unjust result is not called for by the law of estoppel. First, the existence of an estoppel is a question of fact for the trier of fact in each case. (GMAC v. Gandy, 200 Cal. 284, 253 P. 137.) Estoppel rests upon sound equitable principles and the Courts may properly "balance the equities" in determining whether an estoppel is established. (Smith v. Rasqui, 176 C.A. 2d 514 at 519, 1 Cal. Rptr. 478.) Estoppel is a harsh remedy because it prevents a decision on the

merits. Therefore, it is never applied except where to allow the truth would be to consummate a wrong to one party:

"... 'The law does not favor estoppels, for their effect is to prevent the party against whom they are invoked from proving the truth of the matter, to ascertain which, as a general proposition, is the great end of judicial inquiry... The doctrine is a harsh one, and is never to be applied except where to allow the truth to be told would consummate a wrong to the one party or enable the other to secure an unfair advantage.' (Franklin v. Merida, 35 Cal. 558, 566 . . .; Wheaton v. Insurance Company, 76 Cal. 416, 430.)" (Fair Oaks Bank v. Johnson, 198 Cal. 196, at 202, 244 P. 335.)

The required elements of estoppel are clear and each one must be present or there can be no estoppel.

"In order to constitute an equitable estoppel, estoppel by conduct, or estoppel in pais there must exist a false representation or concealment of material facts; it must have been made with knowledge, actual or constructive, of the facts; the party to whom it was made must have been without knowledge or the means of knowledge of the real facts; it must have been made with the intention that it should be acted upon; and the party to whom it was made must have relied on or acted on it to his prejudice." 31 C.J.S. Estoppel §67.

The same elements are recognized in both California and Federal cases. See *Hampton v. Paramount Pictures Corp.* (C.A. 9th) 279 F. 2d 100 at 104, cert. den.

364 U.S. 882, 81 S. Ct. 170, 5 L. Ed. 103; California Cigarette Concessions, Inc. v. City of Los Angeles, 53 C. 2d 865 at 869, 3 Cal. Rptr. 675, 350 P. 2d 715.

The burden of proving each element of equitable estoppel is upon Mr. Clark, the party asserting the defense and each element must be proved by clear, convincing and satisfactory evidence. Cedar Creek toil & Gas Co. v. Fidelity Gas Co. (C.A. 9th) 249 F. 2d 277 at 281, cert. den. 356 U.S. 932, 78 S. Ct. 775, 2 L. Ed. 763.

If any one of the required elements is missing there can be no estoppel. *Riley v. Brown*, 72 C.A. 468 at 478, 237 P. 833.

The Referee's findings which relate to the estoppel issue are fully supported by the evidence:

"On July 23, 1964, petitioner and her husband signed a letter (Ex. 11) at the request of Pasadena Investment Co. (R.T. p. 441, line 11 to p. 442, line 17) stating that they had no counter claims or disputes to their promissory note. Pasadena Investment Co. made no further disclosures to the Weaver Seniors. (R.T. p. 447, line 22 to p. 449, line 9.) Petitioner's husband, Charles L. Weaver, Sr. died on August 18, 1964 (Debtor's Ex. 2; R.T. p. 19, lines 8-9); leaving all of his property to petitioner. He never knew of the fraud of Pasadena Investment Co. nor of the facts found above to constitute grounds for rescission based upon mistake and failure of consideration. (R.T. p. 441, line 11 to p. 442, line 17; R.T. p. 97, lines 1-11; R.T. p. 98, line 15 to p. 101, line 22; R.T. p. 230, lines 16-21.) Neither is he chargeable with such knowledge, constructively or otherwise. Petitioner did not know of the fraud of Pasadena Investment Co. nor of the facts constituting grounds for rescission based upon mistake and failure of consideration (R.T. p. 441, line 11 to p. 442, line 17; R.T. p. 97, lines 1-11; R.T. p. 98, line 15 to p. 101, line 22; R.T. p. 230, lines 16-21) until an investigation commenced by her attorneys at the time notice of default under the trust deed was given. (R.T. p. 101, lines 9-22.) Petitioner is not chargeable with such knowledge prior thereto, either constructively, or otherwise." (Findings of Fact, Paragraph IV, T. p. 57; References to Reporter's Transcript added.)

"... The respondent, William J. Clark, purchased the Weaver, Sr. note and trust deed from Pasadena Investment Co., without recourse, for valuable consideration after the note was mature and the extension of its due date had expired. (Debtor's Exs. 50, 8 and 9; R.T. p. 487, lines 6-8.) Clark had had past business dealings with Pasadena Investment Co. (R.T. p. 487, lines 24-25.) In the negotiations leading to his purchase of the subject past-due note and trust deed, Pasadena Investment Co. showed Clark the note and trust deed, the letter of July 23, 1964 (Ex. 11), and its cancelled check for \$51,000.00 to the Weavers (Ex. 10). (R.T. p. 493, line 20 to p. 495, line 10.) Pasadena Investment Co. falsely represented to Clark that Pasadena's check for \$51,000.00 was the consideration paid by it for the Weaver Senior's \$51,000.00 note and deed of trust. (R.T. p. 495, lines 2-10; R.T. p. 299, line 3 to p. 301, line 3; R.T. p. 474, line 2 to p. 475, line 6.) It

also falsely represented to him that no interest had been paid on the note so that he would be entitled to 16 months of accrued interest in the sum of approximately \$5,440.00 when, in fact \$3,047.98 of interest on this note had been paid to Pasadena Investment Company from Hume Lake Cattle Co. (R.T. p. 493, lines 15-19; R.T. p. 290, lines 17-19.) Clark made no inquiry to the makers of the note, or any of them, before purchasing it but relied on the representations made by Pasadena. (R.T. p. 500, lines 4-17; R.T. p. 493, line 8 to p. 495, line 10.) Pasadena Investment Company is financially solvent and capable of making full restitution to Mr. Clark with whom it has had friendly business relations in the past. (R.T. p. 301, lines 14-20; R.T. p. 421, lines 5-11.) The respondent Clark, having purchased the Weaver Senior note and deed of trust subject to existing personal defenses of the makers against Pasadena Investment Company, under these facts, the court finds that Clark is not entitled to assert equitable estoppel against petitioner." (Findings of Fact, Paragraph V, T. p. 57; References to Reporter's Transcript added.)

Several of the required elements of equitable estoppel are missing in this case. First, when Mr. and Mrs. Weaver, Sr. signed the letter of July 23, 1964 (Debtor's Exhibit 11) stating that in consideration for an extension of the due date of the note "We hereby reaffirm that the amount and terms of said note are correctly stated and that there will be no counter claims or disputes", they were without knowledge, actual or constructive, that the consideration for their note and trust deed was not a loan

of \$51,000.00 as had been represented to them by Pasadena Investment Company. They had no knowledge that in fact Pasadena Investment Company had taken back its check for \$51,000.00 and that no money had passed on August 28, 1963 and that they had grounds to rescind their note and trust deed for fraud, mistake and failure of consideration. (Findings of Fact, Par. IV, T. p. 57.) Without knowledge of the grounds for rescission, Mrs. Weaver cannot be estopped. See *Hampton v. Paramount Pictures Corp.* (C.A. 9th) 279 F. 2d 100 at 104, cert. den. 364 U.S. 882, 81 S. Ct. 170, 5 L. Ed. 103; California Cirgaette Concessions, Inc. v. City of Los Angeles, 53 C. 2d 865 at 869, 3 Cal. Rptr. 675, 350 P. 2d 715.

Second, the "representations" relied upon by Mr. Clark to create an estoppel were not made to Mr. Clark and were not made with the intention that they should be acted upon by any third party. Recall that the statements by the Weavers were in the form of a postscript to a letter from Pasadena Investment Company to them concerning an extension of the due date of the note. Nowhere does it purport to be addressed to Mr. Clark or generally to any third party potential assignee of the note. Contrast this with the facts of Kelly v. Universal Oil Supply Co., 65 Cal. App. 493, 224 P. 261, cited by appellants. The plaintiffs in that case had issued their promissory note with the understanding that it would be negotiated to secure money to start drilling operations under an oil lease which the maker of the note could cancel if drilling operations were not started within a certain period of

time. To further the negotiation of their promissory note, the plaintiffs delivered to the payee of the note is letter addressed to Pacific Mortgage Company dated December 5, 1920 which recited the particulars of Imaking the note, the fact that it was secured, etc. and stated as follows.

"That I have no offsets, claims nor defense against said note except as stated above. I understand that it (is) desired to assign said note and mortgage." (65 Cal. App. at 496.)

This written statement signed by both plaintiffs was made with the expectation that the payee would exhibit it to any person interested in buying the note and he did so on December 8, 1920 receiving \$4,600.00 in cash from one Hamil who then on December 14, 1920 assigned the note to the Glendale National Bank nine days from the date the letter was written. Since there were no conditions attached to the note, the bank did not know that it could be cancelled under the agreement between plaintiffs and the payee if drilling operations were not commenced.

By contrast, in our case the Weavers did not know of the grounds for rescission at the time the letter of July 23, 1964 was signed; they did not sign the letter addressed to potential assignees or with the intent that it be exhibited to any third parties, and the letter they did sign was six months old when Mr. Clark asserts that he relied upon it.

CONCLUSION

The petition of Marguerite J. Weaver to determine the validity of any claims of lien by William J. Clark, Pasadena Investment Company or Title Insurance and Trust Company was fully tried and extensively argued and briefed before Referee Franson before his decision. The presentation of evidence took three very full trial days and the evidence was fully developed. The trial was "summary" only in the limited sense that the term has historically been used to designate the jurisdiction of the Bankruptcy Court to hear and to determine claims against the property owned by the debtor or bankrupt. The Referee, as trier of fact, had full opportunity to observe the manner and demeanor of witnesses and form conclusions concerning their credibility. His findings of fact are fully supported by the evidence and the Referee's Order is fully supported by the law.

Wherefore, Marguerite J. Weaver, as debtor in possession, prays that the District Court's Order affirming the Order of the Bankruptcy Court be affirmed.

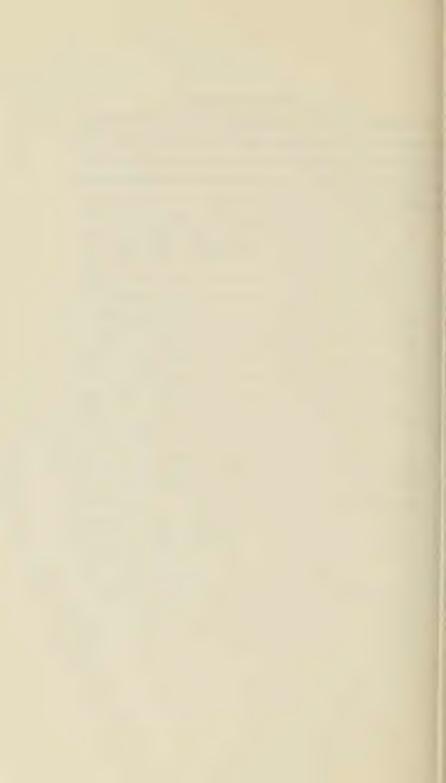
Dated, Fresno, California, November 21, 1966.

Respectfully submitted,
Barrett, Wagner and Dietrich,
By Richard W. Dietrich,
Attorneys for Appellee.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD W. DIETRICH,
Attorney for Appellee.



No. 21003

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PASADENA INVESTMENT COMPANY and WILLIAM J. CLARK,

Appellants,

vs.

MARGUERITE J. WEAVER,

Appellee.

APPELLANTS' REPLY BRIEF.

FILED

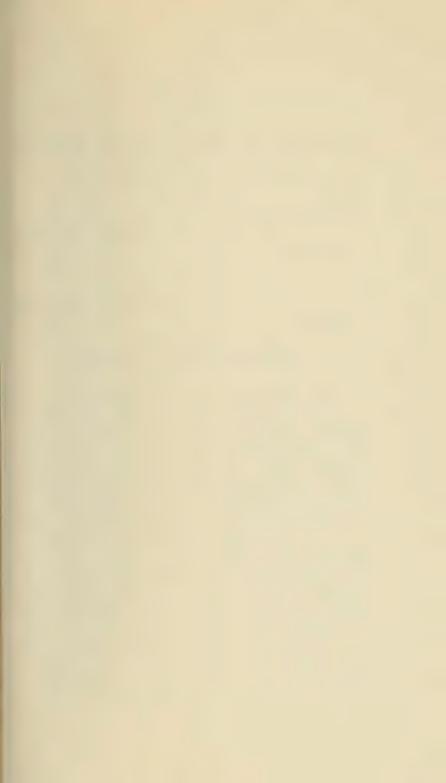
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FEB 15 1967







IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Pasadena Investment Company and William J. Clark,

Appellants,

US.

Marguerite J. Weaver,

Appellee.

APPELLANTS' REPLY BRIEF.

Statement With Respect to Appellee's Brief.

In Appellants' Opening Brief, the points, regarding both the lack of the jurisdiction of the Referee to proceed summarily and the lack of the District Court to proceed and make any adjudication whatsoever regarding a lien, such as Appellants' trust deed in a Chapter 11 proceedings, were clearly dealt with.

In spite of this, Appellee persists in her argument that Appellants waived their right to object to the Referee proceeding summarily to determine the validity of the trust deed lien involved. The auuthorities and the Federal Rules of Civil Procedure were quoted by Appellants to the contrary. Additionally, Appellants went forward and dealt with the general lack of jurisdiction

of the court in a Chapter 11 proceedings to adjudicate liens, citing numerous decisions as well as the statutory limitations which exist with respect thereto.

Nevertheless, Appellee continues to present the same arguments which were presented at the hearing before the Referee. As an example of Appellee's persistence in arguing points which have not even been presented on the Certificate of Review to the District Court or on this appeal, we find Appellee still urging that Appellants had argued that the Probate Court had exclusive jurisdiction of the property after Mr. Weaver Sr.'s demise. The record before Referee Franson indicates that there was some argument to this effect which the Referee properly rejected. Since then, this point has never been urged by Appellants, and, yet, we find Appellee suggesting that it is one of the issues still involved in the case, in spite of the disclaimer contained in Appellants Opening Brief to the contrary.

The first question was whether Appellants had made appropriate objections to the Referee's exercise of summary jurisdiction so as not to have waived the power of the Referee to proceed summarily. The next question was whether the United States District Court had any jurisdiction in a Chapter 11 proceeding to invalidate a trust deed lien held by Appellants on the real property. In the treatment of this last point, Appellee's counsel completely ignores the statutory limitation upon jurisdiction of the Bankruptcy Court as fully and

to the same effect as though there was no distinction between a Chapter 11 arrangement proceeding and any other type of bankruptcy proceeding.

The most that Appellee's brief constitutes is an invitation for us to go back and retrace our steps throughout the arguments made in Appellants' Opening Brief and repeat them. We do not believe that Appellants' Opening Brief, which was filed in this case, is so lacking in clarity and so unsupported by authorities as to merit any such repetitious conduct. We believe that the authorities cited in Appellants' Opening Brief are concise and to the point, and rather than attempt any repetition of these arguments, we believe that we should rest our case upon Appellants' Opening Brief as filed. We are still awaiting a direct response from Appellee's counsel to the authorities which we have cited therein and upon which we rely.

Conclusion.

In concluding this matter, we believe that to the extent that Appellee has any rights meriting protection, there are suitable tribunals in which she can obtain such relief and in which appropriate pleadings can form the issues in a manner in which they can be squarely and fairly presented for determination. Under all of these circumstances, we believe that the decision of the District Court upholding its power and jurisdiction in a proceeding for an arrangement under Chapter 11 to

nullify a contract lien, such as a deed of trust, is erroneous, and that the express statutory limitations, with respect to arrangements and proceedings under Chapter 11, should not be disturbed on any possible basis that the interests of expediency might warrant the same.

Respectfully submitted,

McLaughlin & McLaughlin,
By James A. McLaughlin,
Attorneys for Appellants, Pasadena Investment Co. and William J. Clark.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES A. McLAUGHLIN









